No. 90-1458

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In The

Supreme Court of the United States

October Term, 1990

THE WILLIAMS COMPANIES, INC. AND ITS DOMESTIC SUBSIDIARIES, INCLUDING WILLIAMS NATURAL GAS COMPANY, WILLIAMS PIPE LINE COMPANY, WRC OF MISSOURI, INC., AGRICO CHEMICAL COMPANY, WILLCO, INC. (EDGCOMB METALS COMPANY), WILLBROS TERMINAL COMPANY, AND WRC OF CROWN CENTER, INC.,

Petitioners,

v.

DIRECTOR OF REVENUE, STATE OF MISSOURI,

Respondent.

Petition For A Writ Of Certiorari To The Supreme Court Of Missouri

PETITION FOR A WRIT OF CERTIORARI

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I. QUESTIONS PRESENTED

Missouri law permits (but does not require) an affiliated group of corporations to file a Missouri consolidated income tax return if the affiliated group (i) files a consolidated return for Federal income tax purposes and (ii) derives 50% or more of its income from Missouri sources. Petitioners, an interstate, multicorporate, unitary business, under the umbrella of The Williams Companies, Inc., filed a Federal consolidated return but did not derive 50% or more of their income from Missouri sources for the years at issue. Also, Respondent maintains, and the Missouri Supreme Court held in this case, that Missouri law does not permit the filing of a combined report on a unitary apportionment basis.

For the years at issue, Petitioners initially filed their Missouri corporate income tax returns with the Respondent on a separate corporation basis. Subsequently, Petitioners submitted refund claims to Respondent on a consolidated return or alternatively on a combined report basis.

Also, during the tax years at issue, one of the Petitioners, Williams Pipe Line Company, sold a preferred stock investment, the gain from which Missouri seeks to tax as apportionable "business income."

I. QUESTIONS PRESENTED – continued

The questions presented are:

1. Whether the Missouri Supreme Court erred in denying Petitioners' refund claims on a consolidated return basis because the Missouri statutory requirement that an affiliated group of corporations earn more than 50% of its income in Missouri as a condition to filing consolidated Missouri income tax returns discriminates against interstate commerce in violation of the Commerce Clause of the United States Constitution?

2. Whether the Missouri Supreme Court erred in upholding Missouri's assessment, which apportions capital gain income derived from the sale of preferred stock to Missouri as "business income" under the Multistate Tax Compact, when the seller had no unitary relationship with the issuing corporation, thereby taxing an activity with which Missouri lacks nexus, in violation of the Due Process Clause of the United States Constitution?

PARTIES TO THE PROCEEDING AND RULE 29.1 STATEMENT

Petitioners are Williams Pipe Line Company, The Williams Companies, Inc. ("TWC"), and TWC's domestic subsidiaries for the years 1982 through 1984. The following companies were domestic subsidiaries of TWC during the years at issue (unless otherwise noted, each company listed was a TWC subsidiary during all three years): Agrico Chemical Company; Agrico Chemical Company (Florida); Agrico Chemical Company of Oklahoma, Inc.; Agrico-Asia, Limited (1982 and 1983); Agrico Chemical Properties, Inc. (1982 and 1983); Agrico Thailand, Inc. (1984); Agrico International Far East, Inc.; Agrico North Carolina Properties, Inc.; Agrico Overseas Co., S.A. (1982 and 1983); Agrico Shipping Company; Agrico Trinidad, Inc.; Atria Hotel, Inc.; Cafes on the Ice, Inc.; Carpet Holding Company; Connolly's at the Forum, Inc.; Edgcomb Metals Company (later Willco, Inc.); Faustina Pipe Line Co.; Fishhawk Ranch, Inc.; Kennedy Tower, Inc.; Louisiana Resources Company; Metro Center, Inc.; North Carolina Phosphate Corporation; Northeast Arkansas Transmission Company (1983 and 1984); Paraffine-Williams Company; Rainbow Resources, Inc.; Scissortail Natural Gas Company; The American Agricultural Chemical Company; The Barristers Club, Inc.; Tulsa Union Depot, Inc.; Tulsa Williams Company; Wilchemco Trading, Inc. (1982 and 1983); Willbros Terminal Company; Willcentro, Inc.; Willco Properties, Inc. (1982); Williams Automation Corporation (1982); Williams Realty Development, Inc. (1983 and 1984); Williams Brothers International Corporation; Williams Center Forum, Inc.; Williams Center, Inc.; Williams Center Plant, Inc.; Williams Center Tower I, Inc.;

PARTIES TO THE PROCEEDING – continued

Williams Center Tower II, Inc.; Williams Drilling Company of Tulsa; Williams Exploration Company; Williams Gas Supply Company; Williams Natural Gas Company; Williams Pipe Line Company; Williams Plaza Hotel, Inc.; Williams Real Estate Services, Inc. (1984); Williams Realty Corp.; Williams Realty Interest, Inc.; Williams Realty of Charlotte, Inc.; Williams Redevelopment Corporation (1982); Williams Terminal Co.; WRC of Colorado, Inc.; WRC of Crown Center, Inc. (1984); WRC of Kansas, Inc.; WRC of Missouri, Inc. (1982 and 1983); WRC of St. Louis, Inc. (1982 and 1983); WRC of San Antonio, Inc.; WRC of Texas, Inc.; Writers Square Condominium, Inc.; 1400 Market Street, Inc.; 320 South Boston, Inc.; Williams Northwest Corporation (1983 and 1984); Applied Science, Inc. (1983 and 1984); FT&T, Inc. (1983 and 1984); Inner Ocean Services Company (1983 and 1984); Inner Ocean Services, Inc. (1983 and 1984); Marker International (1983 and 1984); Marker USA (1983 and 1984); NGL Production Company (1983 and 1984); Northwest Alaska Company (1983 and 1984); Northwest Alaskan Pipeline Company (1983 and 1984); Northwest Argentina Corporation (1983 and 1984); Northwest Border Pipeline Company (1983 and 1984); Northwest Canada Exploration Company (1983 and 1984); Northwest Canadian Gas Sales Co. (1983 and 1984); Northwest Carbon Corporation (1983 and 1984); Northwest Central Pipeline Corporation (1983 and 1984); Northwest Coal Company (1983 and 1984); Northwest Ecuador Company (1983 and 1984); Northwest Energy Company (1983 and 1984); Northwest Exploration Company (1983 and 1984); Northwest Field Services

PARTIES TO THE PROCEEDING – continued

Company (1983 and 1984); Northwest Guayaquil Company (1983 and 1984); Northwest Investment, Incorporated (1983 and 1984); Northwest International Company (1983 and 1984); Northwest Land Company (1983 and 1984); Northwest Pipeline Corporation (1983 and 1984); Northwest Production Company (1983 and 1984); Northwest Radio Broadcasting Company (1983 and 1984); Northwest Technical Services Co. (1983 and 1984); Pacific Northwest Realty Corporation (1983 and 1984); SS Properties Incorporated (1983 and 1984); Trans-Intermountain Gas & Energy Resources (1983 and 1984); and Western Slope Carbon, Inc. (1983 and 1984).

The Respondent is Duane Benton, Director of Revenue, State of Missouri.

Per Rule 29.1, the following is a list of all parent companies and subsidiaries (except wholly owned subsidiaries) of each corporation that is a party to this proceeding: For the tax years at issue, TWC was the parent corporation of each of the other above-listed Petitioners. TWC currently is the parent company of over seventy subsidiaries. The following businesses are currently subsidiaries (other than wholly owned subsidiaries) of TWC or are owned in part by wholly-owned subsidiaries of TWC: Apco Argentina Inc.; Northern Border Pipeline Company (a Texas Partnership); BancOklahoma Corp.; Texasgulf Inc.; Centel Facilities Communications (a Texas Partnership); and Interconnect Acquisition Corporation.

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Respondent.

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PETITION FOR A WRIT OF CERTIORARI

Petitioners, The Williams Companies, Inc. ("TWC") and its domestic subsidiaries for the tax years at issue, including Williams Pipe Line Company ("WPL"), respectfully request this Court to issue a Writ of Certiorari to review the judgment of the Supreme Court of Missouri entered in this action on November 20, 1990, to

reverse the same, and to grant Petitioners the relief to which they are entitled.

OPINIONS BELOW

The opinion of the Supreme Court of Missouri (App. 1a) is reported at 799 S.W.2d 602 (Mo. en banc 1990). The order of the Supreme Court of Missouri denying rehearing (App. 12a) is unreported. The decision of the Missouri Administrative Hearing Commission (App. 13a) is unreported. The decision of the Respondent (App. 46a) is unreported.

JURISDICTION

The judgment of the Supreme Court of Missouri was entered on November 20, 1990. Petitioners' timely Motion for Rehearing was denied on December 18, 1990. (App. 13a). This Petition is being filed within ninety (90) days after the entry of the order of the Supreme Court of Missouri denying rehearing. The jurisdiction of this Court is invoked under 28 U.S.C. § 1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Due Process Clause of the Constitution, Amend. XIV, § 1 provides: "[N]or shall any state deprive any person of life, liberty, or property, without due process of law."

The Commerce Clause of the Constitution, Art. I, § 8, cl. 3, provides: "The Congress shall have the power to regulate Commerce with foreign Nations, and among the several States, and with Indian Tribes."

Relevant portions of the Internal Revenue Code of 1954, as amended, for the tax years at issue, 1982-84, as well as Missouri's version of the Multistate Tax Compact, Mo. Rev. Stat. § 32.200 (1969) and portions of the Missouri Income Tax Act, Mo. Rev. Stat. §§ 143.011 *et seq.* (the "Act"), are set forth at App. 74a-113a.

STATEMENT

1. The 50% Source-of-Income Requirement For Filing A Missouri Consolidated Return.

The fundamental issue in this case is the constitutionality, under the Commerce Clause, of the Act's requirement that an affiliated group of corporations derive 50% or more of its income from Missouri sources as a prerequisite to filing a Missouri consolidated income tax return. In 1987, Petitioners filed claims for refund of corporate income taxes with the Respondent, based on a consolidated return or alternatively on a combined report. Because Petitioners did not derive 50% or more of their income from Missouri sources and because Missouri refuses to permit combined reporting (even though it requires apportionment of "business income" under the Multistate Tax Compact), the Petitioners' refund claims were denied.

Petitioners contend that the Act's 50% "source-of-income" requirement violates the Commerce Clause, in

that Petitioners are denied a tax advantage solely because less than 50% of their income, on a consolidated basis, is derived from Missouri sources. Furthermore, because Missouri erred in refusing to permit either a consolidated return or combined report, the separate income of each Petitioner doing business in Missouri, standing alone, did not accurately reflect the portion of each such corporation's income attributable to Missouri, and accordingly, was not fairly apportioned.

Also, Petitioners contend that the capital gain realized by WPL is not apportionable to Missouri as part of WPL's unitary business in Missouri.

Petitioners contend that only combined or consolidated reporting can accurately reflect the taxable income earned by Petitioners in Missouri. It is undisputed that Petitioners operated as a single, interstate, multicorporate, unitary business. (Lf. 354-406).[1] Some, but not all, of the corporations that comprised the Petitioners' unitary business operated in part in the State of Missouri; these are the so-called TWC Missouri Subsidiaries, which are the expressly-named Petitioners in addition to TWC (Lf. 86-88). When considered as distinct units within Petitioners' unitary business, the TWC Missouri Subsidiaries, on the average for the years at issue, were more profitable than were the non-Missouri TWC subsidiaries. Therefore, the taxable income of the TWC Missouri Subsidiaries, considered as separate enterprises, that was apportionable to Missouri under the Act was significantly

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[1] "Lf." refers to the "Legal File," *i.e.*, the reproduced Record filed in the Supreme Court of Missouri.

higher than the actual income from Petitioners' unitary business operations in Missouri.

Because all of TWC's subsidiaries were part of a unitary business, the success of the unitary business in Missouri was inextricably linked with the business of other TWC subsidiaries which did not operate in Missouri but which produced a lower profit margin for the years at issue. In order to fairly apportion income from the unitary business to Missouri, the income generated by all of the corporations constituting Petitioners' unitary business must be consolidated or combined. Nevertheless, the Missouri Supreme Court upheld the flagrantly discriminatory 50% source-of-income requirement in refusing to permit Petitioners to file a consolidated return and inconsistently applied the unitary business concept in refusing to permit Petitioners to file a combined report under the Multistate Tax Compact (the "Compact").

2. Characteristics Of A Consolidated Return.

A consolidated return is a Federal tax concept based solely on the degree of ownership of the common parent, not on the underlying unity of the business activities of the affiliated group. *See* I.R.C. §§ 1501, 1504. A consolidated return disregards the separate corporate structure of the affiliated group members and taxes all members as though they were one taxpayer. *See* Rudolph, *State Taxation and Interstate Business: The Unitary Business Concept and Affiliated Corporations*, 25 Tax L. Rev. 171, 197 (1970); *Caterpillar Tractor Co. v. Dept. of Revenue*, 289 Or. 885, 618 P.2d 1261, 1263 (1980).

A combined report, in contrast, is a state tax concept applied to an interstate, multicorporate, unitary business.

Its underpinning is the unitary business concept, rather than percentage of stock ownership. The purpose of a combined report is to permit a fair determination of that portion of a business' income attributable to business activity in the state by the reporting members of a unitary group. The combined report, in effect, "combines" the income of the entire unitary business to determine fairly the corporate member's state taxable income. *See* Rudolph, at 197; *Caterpillar*, 618 P.2d at 1262-63.

3. The Missouri Supreme Court's Opinion.

There are clearly practical and theoretical differences between combined reporting on a unitary basis and a consolidated return. Despite such differences, the Missouri Supreme Court, in its opinion below, characterized the 50% source-of-income test for filing a Missouri consolidated return as an aspect of the unitary business principle, holding that the source-of-income requirement was:

> [f]ashioned on the principle that formula apportionment of the income of the unitary affiliated group is more likely to be "fairly apportioned, nondiscriminatory, sufficiently connected with the taxpayer's state activities, and fairly related to state benefits provided the taxpayer," [citation omitted], when the affiliated group derives the majority of its income from in-state sources. Conversely, when the unitary group's income derives primarily from sources outside the state, formula apportionment of the income of only those subsidiaries with direct relationships to the State yields a corpus of income more reasonably related to the group's activities within the state. [citation omitted]. This presupposes some coincidence between the economic and

> legal structures of the consolidated business, which may not exist in every case. [citation omitted]. However, the legal form in which a taxpayer clothes its business is one of its own choosing.

779 S.W.2d at 605. By its express terms, the Missouri consolidated return statute says nothing about a unitary business; it requires only the filing of a Federal consolidated return and the proper source of income. However, the Missouri Supreme Court's purported justification for the source-of-income requirement was that it enhances the likelihood that there is a fair or reasonable relationship between a unitary group's business activities and the taxing state, *i.e.*, it is a nexus requirement.

With respect to the contention that the "source-of-income" requirement discriminates against out-of-state businesses, the Missouri Supreme Court indicated that Petitioners could have avoided any discrimination by "choosing" to conduct their business in a single corporate form rather than in a multicorporate form. The Court reasoned that the requirement "does not additionally tax Appellants due to their interstate activities. Rather, the increased tax in this case results from the fact that the members of the group that generated losses and other tax savings are incorporated separately from the Missouri subsidiaries." *Id.* Therefore, according to the Missouri Supreme Court, to deny consolidation of "losses accrued outside of Missouri with profits generated inside the state *when there is no clear nexus* between them (*manifest by accruing under a single corporate franchise, or to a group deriving the majority of income from sources within the State*) does not discriminate against interstate commerce." *Id.* (Emphases added). In short, the Missouri Supreme Court

implicitly denied that the purpose of the 50% source-of-income test was to favor Missouri-based business activity, blamed Petitioners for any discriminatory effect, and determined that a facially discriminatory filing requirement passes constitutional muster. Therefore, Petitioners' refund claims based on consolidated returns were denied.

With respect to Petitioners' alternative contention that the Compact required or permitted a combined report, the Court replied that the Compact was not intended to be a "substantive tax statute" and does not "impose a tax but merely computes the tax imposed." *Id.* at 606. Therefore, Petitioners' refund claims based on combined reporting also were denied.[2]

4. The Refund Claims And The Tax Assessment Against Petitioners.

A. The Petitioners.

TWC is a Delaware corporation which is domesticated and has its principal place of business in Tulsa, Oklahoma. (Lf. 85). During the years at issue, TWC was the parent company of numerous corporations, which, along with TWC, are the Petitioners. (Lf. 85-88). Those TWC subsidiaries which were qualified to do business in Missouri in the years at issue, the TWC Missouri Subsidiaries, are the expressly-named Petitioners in addition to TWC. (Lf. 86-88). The TWC Missouri Subsidiaries initially filed separate Missouri corporate income tax returns for

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[2] Since the Missouri Supreme Court's disposition of the combined report issue does not present a Federal question, it is not at issue in this appeal.

the years at issue. (Joint Exhibits 9-21).[3] However, TWC and its subsidiaries filed consolidated Federal income tax returns for the years 1982-1984. (Joint Exhibits 40-42). TWC and its subsidiaries comprised a unitary business. (Lf. 354-406).

WPL, a wholly-owned subsidiary of TWC and one of the Petitioners, is a Delaware corporation with its principal place of business in Tulsa, Oklahoma. WPL is a common carrier pipeline company whose commercial domicile was, and is, the State of Oklahoma. WPL was qualified to do business in Missouri for the tax years at issue. (Lf. 87).

B. The Refund Claims.

The Petitioners' refund claims were initiated on January 6, 1987, when TWC sent a letter to the Respondent announcing Petitioners' intention to seek a refund on a combined report basis or, in the alternative, to file a Missouri consolidated return, with respect to income taxes paid to Missouri by the TWC Missouri Subsidiaries for the years 1982-84. On January 22, 1987, the Petitioners filed with the Respondent claims for refund or credit of Missouri corporate income taxes, which, after certain adjustments not material to this proceeding, would, if granted, result in a refund of $2,702,546. Although the refund claims were calculated on the basis of combined reporting, the taxable income shown on the refund claims was identical to that which would have been derived if

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[3] The Joint Exhibits are a part of the reproduced Record filed in the Supreme Court of Missouri.

Petitioners had filed consolidated returns in Missouri. (Joint Exhibit 1A, ¶¶ 27, 28, 31-34).

By letter dated July 17, 1987, the Respondent denied in full the refund claims. (Joint Exhibit 38). TWC then timely filed a Protest, dated September 15, 1987, of the denial of the Refund Claims. (Joint Exhibit 39). By decision dated February 24, 1988 (the "Respondent's Decision"), the Respondent denied the Petitioners' Protest. (App. 46a).[4]

C. The WPL Capital Gain.

In 1986, the Respondent issued Final Notices of State Income Tax Deficiency against WPL for the 1984 tax year. (Lf. 89). Respondent proposed to assess additional taxes and interest, which, after certain corrections not material to this proceeding, would equal $109,746. (Joint Exhibit 35). This deficiency arose because the Respondent proposed to include, in WPL's taxable income apportionable to Missouri for 1984, the capital gain realized by WPL from its sale of preferred stock in Wood River Pipeline Corporation (the "WPL Capital Gain"). (Joint Exhibit 35). On its 1984 return, WPL had allocated the WPL Capital Gain solely to Oklahoma, WPL's commercial domicile. (Lf. 93).

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[4] The Respondent's Decision and the Missouri Supreme Court's opinion also upheld taxation of certain interest income of Williams Natural Gas Company as apportionable "business income." Petitioners are not seeking review of that portion of the Missouri Supreme Court's opinion.

The genesis of the WPL Capital Gain was a 1980 transaction in which WPL agreed to contribute one of its pipelines and certain right-of-way easements as part of an investment in a newly-created corporation, Wood River Pipeline Corporation ("Wood River"), to be controlled by Koch Industries ("Koch"). (Tr. 40-42).[5] Koch received all 8,000 shares of Wood River common stock, while WPL received 2,000 shares of cumulative non-voting preferred stock.

Under the agreement between Koch and WPL which created Wood River, Koch controlled Wood River: WPL's preferred stock holdings entitled it to elect only one director, while Koch elected the remaining four. (Tr. 49). WPL and Wood River had no common officers, directors, or employees. (Tr. 49). As a preferred stockholder, WPL did not share in the profits of Wood River, but was entitled to quarterly preferred dividends in a fixed amount. (Certificate of Incorporation of Wood River ("Cert.") pp. 6, 7).[6] Wood River was not required to make immediate payment of preferred dividends if its profits failed to reach a certain level; however, if Wood River did not pay any preferred dividend within 36 months of its scheduled declaration date, it would be in "default." (Cert. pp. 6, 7). If default occurred, the board of directors

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[5] "Tr." refers to the Transcript of the Hearing in the administrative proceedings below before the Missouri Administrative Hearing Commission, which are a part of the reproduced Record filed with the Missouri Supreme Court.

[6] The Certificate of Incorporation is one of several documents relating to Wood River which appear in the record as Appellants' Exhibit 52 submitted to the Missouri Administrative Hearing Commission.

of Wood River would be reconstituted so as to provide WPL with control. (Cert. pp. 14, 15). Wood River regularly paid preferred dividends, so the default provision never went into effect. (Tr. 50). On January 5, 1984, WPL sold its Wood River preferred stock to Koch, giving rise to the WPL Capital Gain at issue. The Respondent's Decision upheld the proposed assessment against WPL with respect to the WPL Capital Gain.

5. The Proceedings Below.

The Petitioners timely appealed the Respondent's Decision to the Missouri Administrative Hearing Commission (the "Commission") by filing their Complaint on March 23, 1988, in which all of the constitutional claims presented herein were timely and properly raised. (Lf. 28, 29, 32). After a Hearing held on November 23, 1988, the Commission issued its Final Decision on December 12, 1989, denying the Refund Claims and upholding the assessment with respect to the WPL Capital Gain. (App. 13a). The Commission's Final Decision rejected Petitioners' Due Process Clause objections to taxation of the WPL Capital Gain but declined to consider Petitioners' properly presented Commerce Clause objection to the 50% source-of-income requirement for filing a consolidated return. (App. 38a-45a). Petitioners timely appealed the Commission's Final Decision to the Missouri Supreme Court by filing a Petition for Review on January 10, 1990, in which all of the constitutional claims presented herein were timely and properly raised. (App. 116a, 117a). After oral argument held on September 7, 1990, the Missouri Supreme Court's opinion was issued on November 20, 1990. The Petitioners' timely Motion for Rehearing was denied on December 18, 1990.

In its opinion, the Missouri Supreme Court upheld the denial of Petitioners' refund claims and upheld the assessment with respect to the WPL Capital Gain, rejecting all of the constitutional claims raised herein. 799 S.W.2d at 604-07. However, the Court remanded to the Commission an issue with respect to the proposed assessment of an "addition to the tax" in the nature of a penalty. *Id.* at 607. By subsequent agreement between Petitioners and Respondent, Petitioners have deposited all of the additional income tax and interest assessed, pending disposition of this Petition for a Writ of Certiorari, and in turn, the Respondent has agreed to withdraw the remanded issue involving the "addition to the tax."

Petitioners have no complaint with respect to any of the facts found by the Commission involving the consolidated return/combined report issue. Although Petitioners maintained before the Missouri Supreme Court that certain of the facts found by the Commission with respect to the WPL Capital Gain issue were misleading or otherwise unsupported, for purposes of this appeal, the only issue Petitioners raise with respect to the taxation of the WPL Capital Gain is a matter of law under the Due Process Clause.

THE REASONS FOR GRANTING THE WRIT

The following are special and important reasons that the Writ should be granted:

1. **The Missouri Supreme Court's Opinion Upholding The Discriminatory 50% Source-Of-Income Requirement Decided A Federal Question Under The Commerce Clause In A Way That Clearly Conflicts With Applicable Decisions Of This Court And With A Decision Of Another State Court Of Last Resort.**

This Court's precedents clearly provide that conditioning the incidence of taxation on "the percentage of a

specific segment of the corporation's business that is conducted in [a] state" is an "impermissible basis" for taxation of an interstate business under the Commerce Clause. *Westinghouse Electric Corp. v. Tully*, 466 U.S. 388 (1984). Missouri law impermissibly conditions a tax advantage – permission to file a consolidated return – on such a "percentage of a specific segment," namely 50% or more, of the affiliated group's income being from Missouri sources. The Missouri Supreme Court has conceded that "there are instances where there is a *tax advantage* in filing a consolidated federal income tax return" and that the inability to file a Missouri consolidated income tax return may constitute a *"burden"* on the affected taxpayer. *Mid-America Television v. State Tax Commission*, 652 S.W.2d 674, 681 (Mo. en banc 1983), *cert. denied*, 465 U.S. 1065 (1984) (Emphasis added). Consequently, the 50% source-of-income requirement operates as a burden on interstate commerce and is unconstitutional.

There is no legislative history behind the Act's source-of-income requirement that could help to clearly determine the Missouri legislature's purpose in enacting it. Nevertheless, in its opinion, the Missouri Supreme Court indicated that the source-of-income requirement was designed to ensure "clear nexus" which is "manifest by accruing under a single corporate franchise, or to a group deriving the majority of income from sources within the State." 799 S.W.2d at 605. This judicial justification of the source-of-income requirement cannot withstand close analysis. "Nexus" is a Due Process requirement providing the "minimal connection" between a taxpayer's activities and a taxing state. *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 272-3 (1978). Traditionally, nexus is a requirement satisfied by presence, *i.e.*,

doing business in the State, or more recently, with respect to a unitary business, conducting some portion of the unitary business in the taxing state. Here, there is no question that nexus *is* present – Petitioners are part of an interstate, unitary business operating in Missouri – so Missouri may tax an apportioned share of the Petitioners' combined or consolidated income without taxing "value earned outside its borders." *ASARCO, Inc. v. Idaho State Tax Commission*, 458 U.S. 307, 315 (1982).

Indeed, there is no necessary relationship between a true nexus requirement and a source-of-income requirement; whether a group of related corporations is present or conducting a unitary business within a state is a separate determination from the percentage of business done in the state. Even the Missouri Supreme Court indicated, in its opinion, that the link between nexus and the source-of-income "presupposes some coincidence between the economic and legal structures of the consolidated business, which may not exist in every case." 799 S.W.2d at 605. Surely any such link would be purely "coincidental" because a unitary business determination is independent of the state to which the income can be sourced. However, even if these two concepts were logically related, Missouri cannot, under the rubric of "nexus," condition a tax advantage on the percentage of an affiliated group's business conducted in the State without violating the Commerce Clause. In short, the purported rationale for the source-of-income requirement is merely a pretext for a discriminatory intent to attract additional interstate business activity to Missouri by offering the tax advantage of filing a consolidated return.

In any event, this Court has made it clear that the Commerce Clause inquiry must focus on the "actual

effect" of the tax, irrespective of the legislative intent underlying the tax. "In each case it is our duty to determine whether the statute under attack, whatever its name may be, will in practical operation work discrimination against interstate commerce." *Best & Co. v. Maxwell*, 311 U.S. 454, 455-56 (1940). Thus, it makes no difference, for Commerce Clause purposes, whether the Missouri Legislature's effective discrimination against interstate commerce is intentional, since the "actual effect" of the tax is discriminatory.

The source-of-income requirement has the discriminatory effect of taxing the same amount of income apportioned to Missouri by two different groups of affiliated taxpayers at different effective rates, depending *solely* on the state in which the affiliated group conducts a majority of its business activity. This can be demonstrated by a simple example. Assume that an affiliated group of corporations, ABC, derives 51% of its income from business in Missouri, with $100 of income from subsidiaries operating in Missouri and $50 of losses from subsidiaries operating outside Missouri. Further assume that a second affiliated group of corporations, XYZ, derives 49% of its income from business in Missouri, but derives the same income from subsidiaries operating in, and losses from subsidiaries operating outside, Missouri as the ABC group. Because the ABC group meets the 50% source-of-income requirement, it could net its operating income and losses, resulting in a $50 Missouri tax base. However, because the XYZ group does not satisfy the 50% source-of-income requirement, such netting of income and losses is not permitted, resulting in a Missouri tax base of $100. Although the tax rate imposed on the income tax base of both groups is nominally the same, the XYZ group will

pay twice the amount of tax on the same income as the ABC group. The practical *effect* of the 50% source-of-income requirement is to impose different tax rates on the consolidated income of the two affiliated groups, by irrationally increasing the tax base of the affiliated group which does not satisfy a requirement based solely on the state from which the income is earned. This is precisely the kind of discrimination that is forbidden by the Commerce Clause. "A state tax that favors in-state business over out-of-state business for no other reason than the location of its business is prohibited by the Commerce Clause." *American Trucking Ass'ns, Inc. v. Scheiner*, 483 U.S. 266, 286 (1987).

Although the 50% source-of-income requirement equally burdens resident and non-resident corporate taxpayers, it nevertheless discriminates against interstate business *activity* which is conducted primarily outside the State of Missouri. In addition, a locally-based Missouri business would be more likely than a non-Missouri based business to satisfy the requirement since the locus of business activity is often linked to local residency. However, even if this were not so, the 50% source-of-income requirement would still burden interstate commerce. "A State may no more use discriminatory taxes to assure that nonresidents direct their commerce to businesses within the State than to assure that residents trade only in intrastate commerce" by extending a tax advantage favoring locally-based business activity. *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318, 334-5 (1987). The Missouri 50% source-of-income requirement penalizes interstate businesses by prohibiting certain taxpayers from obtaining the tax advantage of a consolidated return so

that state boundaries are not a "neutral factor in economic decision-making." *American Trucking*, 483 U.S. at 283. As a result, this requirement impermissibly "exerts an inexorable hydraulic pressure" on interstate businesses to shift their operations to Missouri in order to obtain the reward of a consolidated return. *Id.* at 286-87.

This Court has consistently invalidated similar discriminatory attempts by states to provide tax advantages to business activity within their borders at the expense of business activity in other states. For example, in *Boston Stock Exchange*, this Court struck down, under the Commerce Clause, an amendment to the New York stock transfer tax by which (i) the tax rate for transactions by non-residents was *cut by 50%* when the transaction involved an in-state sale, but not when it involved an out-of-state sale; and (ii) a maximum tax of $350 was applied to a single transaction, irrespective of the taxpayer's state of residence, when the sale took place in-state, but no ceiling was placed on the tax if the sale took place out-of-state. Like the transfer tax in *Boston Stock Exchange*, the income tax in this case "imposes a greater tax liability on out-of-state sales than on in-state sales [and therefore] falls short of the substantially even-handed treatment demanded by the Commerce Clause." *Boston Stock Exchange*, 429 U.S. at 332.

The *Boston Stock Exchange* standard applies to income taxes as well as to taxes on transactions. In *Westinghouse*, this court struck down a credit against income-based franchise taxes, where the credit was granted to corporations against taxes on accumulated income of their DISC subsidiaries based on the portion of the DISC's export revenues derived from shipments originating in New York. *Westinghouse*, 466 U.S. at 394-5. The parent earned a

greater tax credit as its DISC subsidiary moved a greater percentage of its shipping activities into New York. *Id.* at 400. This Court found that the distinction between a transaction tax and an income tax credit was irrelevant: "It cannot be that a State can circumvent the prohibition of the Commerce Clause against placing burdensome taxes on out-of-state transactions by burdening those transactions with a tax that is levied in the aggregate – as is the franchise tax – rather than on individual transactions." *Id.*, at 404.

Similarly, in *Maryland v. Louisiana*, 451 U.S. 725 (1981), this Court struck down Louisiana's severance tax on natural gas, under which in-state users of gas paid a lower tax, through source-based exemptions and credits, than out-of-state purchasers. More recently, this Court struck down the West Virginia gross receipts tax in *Armco, Inc. v. Hardesty*, 467 U.S. 638 (1984), because businesses engaged in local manufacturing activity were exempt from the tax. The effect of the facially discriminatory exemption was "that two companies selling tangible property at wholesale in West Virginia will be treated differently depending on whether the taxpayer conducts manufacturing in the State or out of it." *Id.*, at 642. Also, in *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984), this Court struck down a Hawaii excise tax imposed on sales of liquor at wholesale which exempted from the tax certain locally-produced alcoholic beverages. Clearly, a tax which adversely affects interstate business activity to the advantage of intrastate business activity cannot survive Commerce Clause scrutiny.

The Missouri Supreme Court failed to properly distinguish these precedents in holding that it is "the legal

form in which a taxpayer clothes its business" that results in the discriminatory effect of the consolidated return requirement. 799 S.W.2d at 605. On the basis of the Missouri Supreme Court's opinion, Petitioners could only reflect all of the affiliated group's income and losses in a Missouri corporate income tax return if *all* but one of their corporate structures were dissolved and Petitioners became one company. Such a "choice" would have seriously disrupted the business activities of the over ninety subsidiaries in TWC's affiliated group during the periods at issue. In any event, even a massive fusion into one corporation would *not* satisfy the consolidated return source-of-income requirement (although it would moot the issue). Only by shifting business across state lines can the source-of-income requirement be met. Clearly, the opinion's reliance on the taxpayer's own "choice" is illusory and constitutionally impermissible. Further, the implication of this holding – that if the discrimination can be avoided by the taxpayer, a discriminatory tax structure does not violate the Commerce Clause – is novel, dangerous and erroneous. Even assuming it to be correct, this argument proves too much. It could be used to justify *any* discriminatory tax so long as the taxpayer could "choose" to alter its interstate business to avoid the discrimination. The Commerce Clause is designed to protect interstate business from such "choices."

The class which is extended the tax advantage of the filing requirement must be chosen in a constitutionally permissible manner. Missouri would never contend that, since it may constitutionally impose an income tax on income derived from Missouri sources, it could establish different corporate income tax rates depending on the portion of the business derived from Missouri sources.

Yet, this is precisely the effect which the Missouri 50% source-of-income filing requirement has accomplished "through the back door."

The foregoing precedents clearly stand for the proposition that a tax or tax structure (such as a tax exemption or credit) that on its face prefers some or all intrastate business activity is unconstitutional, except in narrowly limited circumstances in which such a facially discriminatory tax can be found to "compensate" for an equivalent tax applied exclusively to intrastate business activity. Missouri has made no claim that the filing requirement of the Act is compensatory.

To the best of Petitioners' knowledge, this Court has never considered a discriminatory filing requirement in a Commerce Clause context. Nevertheless, this Court has not hesitated to invalidate any tax structure, irrespective of its form, that has a discriminatory effect. The Missouri source-of-income filing requirement is merely another incidence of the improper extension of a tax advantage favoring intrastate business and penalizing interstate business. Accordingly, the filing requirement is squarely within the reach of this Court's decisions striking down other discriminatory state taxes.

This Court has always "declined to undertake the essentially legislative task of establishing a 'single constitutionally mandated method of taxation.' " *Trinova Corp. v. Michigan Dept. of Treas.*, ___ U.S. ___, 111 S.Ct. 818 (1991). Indeed, it is clear that Missouri remains free to permit or deny the filing of consolidated returns in a constitutionally permissible manner. However, it is equally clear that this Court has not tolerated discriminatory methods of taxation. What the Missouri Supreme Court failed to recognize is that it is unconstitutional

under our Federal system for a State to encourage a company to shift a greater percentage of its interstate business activities across state lines to obtain a tax advantage.

The fact that the Missouri source-of-income requirement might not constitute a "burden" to an affiliated group of corporations whose non-Missouri subsidiaries were more profitable than its Missouri subsidiaries does not alleviate the impermissible discrimination. The degree of the burden imposed by the Missouri requirement need not be considered. "When a tax, on its face, is designed to have discriminatory economic effects, the court 'need not know how unequal the Tax is before concluding that it unconstitutionally discriminates.' " *Westinghouse*, 466 U.S. at 406-7 (citation omitted). Similarly, where, as here, the Missouri income requirement on its face has "discriminatory economic effects," the discriminatory impact need not be confirmed by examining the tax burdens imposed by other states. *Tyler Pipe Industries v. Washington Dept. of Revenue*, 483 U.S. 232, 241-42 (1987). Any discrimination that harms some interstate businesses violates the Commerce Clause, even though other interstate businesses may be unaffected or even favored by the discriminatory tax. *American Trucking*, 483 U.S. at 286 ("Nor is the axle tax saved because some out-of-state carriers which accrue high mileage in Pennsylvania pay the axle tax at a lower per-mile rate than some Pennsylvania-based carriers").

The discriminatory effects of the Missouri Supreme Court's decision are not limited to the thousands of interstate corporations doing business in Missouri. Discriminatory filing barriers, such as the Missouri 50% source-of-

income requirement, threaten to undermine the protections afforded by the Commerce Clause. Since state legislatures are under pressure to raise revenue but are responsive to political pressures to protect the parochial interests of businesses operating within their states, discriminatory filing barriers provide an attractive incentive for encouraging locally-based business activity at the expense of interstate business. Indeed, because out-of-state businesses are limited in the extent to which they may exert countervailing pressures, this Court has recognized the need for judicial vigilance in enforcing the Commerce Clause. *See, e.g., Commonwealth Edison Co. v. Montana,* 453 U.S. 609, 615 (1981). Reversal of the Missouri Supreme Court's decision would clearly signal to the States that indirect circumvention of the Commerce Clause through discriminatory tax structures will not be tolerated. In short, the decision below is inconsistent with decisions of this Court and warrants correction.

In addition, the decision of the Missouri Supreme Court is inconsistent with at least one decision of another state court of last resort on a closely-related issue. In *Delta Airlines v. Dept. of Revenue,* 455 So.2d 317 (Fla. 1984), the Florida Supreme Court invalidated, on Commerce Clause grounds, a credit of $5 million against corporate income tax for air common carriers who have a corporate or business home office in Florida and also maintain a work-force of more than 1,200 employees in the State, since it provided a direct commercial advantage to Florida-based air carriers and not to out-of-state air carriers. Relying on this Court's precedent of *Boston Stock Exchange,* the Florida Supreme Court struck down the credit structure of the tax because it favored in-state business activity and discriminated against interstate

commerce. *Id.* at 319-21. Here, the discriminatory tax filing structure of the Act similarly favors in-state business activity to the detriment of interstate commerce. As a result, the Missouri Supreme Court has decided a Federal question in a way that conflicts with the decision of another state court of last resort.

Also in conflict with the Missouri Supreme Court's decision is the decision of the Court of Special Appeals of Maryland (Maryland's intermediate appellate court) in *Comptroller of the Treasury, Income Tax Division v. Armco, Inc.*, 70 Md. App. 403, 521 A.2d 785 (Ct. Sp. App. 1986). There, the Maryland Court held that it was unconstitutional for the State to grant an exclusion from a corporation's taxable income of deemed income of an affiliated DISC only where the parent corporation had at least 50% of its net income allocable to the State. The Maryland court recognized that such a 50% limitation was a case "simply . . . of discrimination" and that, under this Court's precedents, the 50% exclusion "impermissibly discriminated on the basis of location of a corporation's business." *Id.* at 413, 521 A.2d at 790. Further, the Court recognized that "[w]hile the Legislature may certainly decide what to exclude from taxable income, it may not limit that exclusion to Maryland businesses only." *Id.* Similarly, Missouri may not extend the privilege of filing a consolidated return to only primarily local businesses based on a comparable 50% source-based test.

Further, a decision permitting Petitioners to file their Missouri corporate income tax return on a combined or consolidated basis would ensure "fair apportionment" under the Commerce Clause. Separate company accounting ignores the interdependence and integration of the TWC Missouri Subsidiaries, because a unitary business

has a high degree of interdependence in its relationship among related corporations. Because all of TWC's subsidiaries are part of the unitary business, there is a "flow of *value*" not capable of precise definition, which permeates the business relationships among Petitioners. *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159, 179 (1983) (emphasis in original). This "flow of *value*" results from "functional integration, centralization of management, and economies of scale" in the unitary group. *Id.* Consequently, it is impossible to fairly apportion the taxable income generated within Missouri by a single corporate member of the unitary group absent a combined report or a consolidated return. As a result, the Missouri Supreme Court has erred in refusing to permit a consolidated return by Petitioners.

2. The Missouri Supreme Court's Opinion Upholding Apportionment Of The WPL Capital Gain As Unitary "Business Income" Decided A Federal Question Under The Due Process Clause In A Way That Conflicts With Decisions Of This Court.

The Missouri Supreme Court, in its opinion, found that WPL's interest in Wood River was unitary with WPL and that, therefore, the WPL Capital Gain was apportionable to Missouri as part of WPL's unitary business income. In so holding, the Missouri Supreme Court decided a Federal question in a manner that conflicts with applicable decisions of this Court. Specifically, the Missouri Supreme Court misunderstood the requirement of this Court's precedents that *control*, derived through substantial ownership of the business, exist as a necessary element of a unitary business finding. As a result, apportionment to Missouri of the WPL Capital Gain

results in taxation of an activity with which Missouri lacks nexus in violation of the Due Process Clause. *ASARCO; See also F.W. Woolworth Co. v. Taxation and Revenue Dept.*, 458 U.S. 354 (1982).

It is undisputed, and the Missouri Supreme Court properly found, that "Koch Industries, Inc., controlled" Wood River. 799 S.W.2d at 606. However, the Missouri Supreme Court did not regard such control as being essential for the existence of a unitary business. Rather, the Missouri Supreme Court found the existence of a unitary business because (i) WPL's investment was purportedly in the "same line of work as itself"[7] thereby "making better use . . . of the parent's existing resources" (quoting from *Container Corp.*, 463 U.S. at 178), (ii) WPL "contributed or sold substantial properties, services and expertise to Wood River Pipeline Company,"[8] and (iii) "Wood River owes its very existence to Williams Pipe Line's involvement in the enterprise."[9] 799 S.W.2d at 607.

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[7] Although it is true that WPL and Wood River were both pipeline companies, Wood River shipped crude oil exclusively while WPL primarily shipped refined petroleum products, fertilizer and liquid petroleum gas. As Petitioners argued to the Missouri Supreme Court, these businesses are significantly different.

[8] However, as the Missouri Supreme Court's opinion properly notes, WPL was compensated for all services rendered to Wood River pursuant to agreements between the parties and not as a result of WPL's minority ownership of Wood River preferred stock.

[9] Under this Court's precedents, this conclusion is irrelevant to a unitary business finding.

The fundamental flaw of the Missouri Supreme Court's analysis is in analogizing WPL's minority, non-voting preferred stock ownership in Wood River to the stock ownership present in *Container Corp.* There, the subsidiary was wholly-owned by the parent corporation. Under this Court's precedents, a minority investment in a subsidiary that provides the investor no significant degree of control over the business is merely a passive investment, not part of a unitary business.

Petitioners are unaware of any case in which a unitary business has been found to exist where one of the two businesses did not control the other. Indeed, the absence of the requisite degree of control precluded a unitary relationship in both *ASARCO* and *Woolworth*. In *ASARCO*, the taxpayer owned all the stock of the subsidiaries at issue. However, the taxpayer had foregone its capacity to control its subsidiaries, pursuant to agreements with other owners or the Department of Justice or by voluntary decisions not to exercise its right to elect directors. *ASARCO*, 458 U.S. at 322-25. In *Woolworth*, even though the taxpayer exercised approval rights over major decisions regarding debt and dividends of its subsidiaries, and frequent communication occurred between upper level management of the parent and the subsidiary, this Court found that such relationship amounted to only the "occasional oversight" that any parent gives to a subsidiary. *Woolworth*, 458 U.S. at 368-69. Further, Woolworth owned "all the stock of three of its dividend payors and a 52.7% majority interest in the fourth." *Id.* at 362. Even this degree of majority ownership was not adequate to cause "control" to exist in *Woolworth*. Quite clearly, control means more than simply the existence of some business relationship between two entities or the

mere potential for control. In cases involving two corporations, they have been found to be unitary only where one had *majority* ownership of the other.

Indeed, this Court's decision in *Container* acknowledges that there is a "degree of common ownership which is *prerequisite* to the definition of unitariness." *Container*, 463 U.S. at 177, n. 16 (emphasis added). Here, Koch owned all of the common stock of Wood River and elected four of the five members of Wood River's Board of Directors and, thereby, controlled Wood River. Further, Wood River and WPL had no common officers or employees and WPL elected only one of Wood River's five Directors. Without the requisite degree of ownership to control Wood River, the Missouri Supreme Court's conclusion that WPL and Wood River operated as a single unitary business is erroneous as a matter of law.

This Court's decision in *Container Corp.*, on which the Missouri Supreme Court relied, did not "toss out" the requirement of control and replace it with the "flow of *value*" test, which is also a prerequisite to finding a unitary business. *Container*, 463 U.S. at 178 (emphasis in original). However, under the "flow of *value*" test, WPL and Wood River also were not unitary. Although WPL had certain limited rights as a preferred shareholder, it had no control over and no role in Wood River's purchasing, budgeting, advertising, personnel policies, research, or any other administrative or operational details. WPL performed surveying services, construction inspection, and certain maintenance and repair work on parts of Wood River's pipeline which ran through WPL's rights-of-way, but these services were performed to protect WPL's *own* vested interest in its rights-of-way rather than to enhance the value of Wood River. Moreover, these

services were performed because of the proximity of WPL's own pipelines, rather than because of WPL's status as a preferred shareholder, as evidenced by the fact that WPL continued to perform such services *after* selling its Wood River preferred stock.

In addition, WPL paid Wood River market rates for all shipments through any portion of Wood River's system during the short period from December, 1981, to early May, 1982, when their pipelines were interconnected. As required by written agreements between Wood River and WPL, all transactions between them were "at arm's length." In short, no "flow of *value*" occurred. Based on the foregoing, the Missouri Supreme Court has erroneously applied this Court's precedents regarding a unitary business finding and such error of law should be corrected.

CONCLUSION

The questions presented by this appeal are important because of the significant burden on interstate commerce imposed by the Missouri 50% source-of-income requirement and the conflict of the Missouri decision with the decisions of this Court and of the highest court of another state. This Court should accept this case to uphold "one of the fundamental principles of Commerce Clause jurisprudence . . . that no State, consistent with the Commerce Clause, may 'impose a tax which discriminates against interstate commerce . . . by providing a direct commercial advantage to local business.' " *Maryland v. Louisiana*, 451 U.S. at 754 (1981) (quoting from *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 458 (1959)).

For the foregoing reasons, a Writ of Certiorari should issue to the Missouri Supreme Court.

Respectfully submitted,

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The WILLIAMS COMPANIES, INC., etc., et al., Appellants,

v.

DIRECTOR OF REVENUE, Respondent.

No. 72352.

Supreme Court of Missouri, En Banc.

Nov. 20, 1990.

Rehearing Denied Dec. 18, 1990.

J. Kent Lowry, Jefferson City, Henry G. Will, Martin R. Wing, and Bret J. Masterson, Tulsa, Okl., for appellants.

William L. Webster, Atty. Gen., Richard Wieler, Asst. Atty. Gen., George Cox, and Ronald J. Miller, Sp. Asst. Attys. Gen., Dept. of Revenue, Jefferson City, for respondent.

BILLINGS, Judge.

The principal issue in this case is whether The Williams Companies, Inc., and seven of its subsidiaries that did business in Missouri in 1982 through 1984[1] had the right to file a consolidated or combined Missouri income

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[1] These subsidiaries are Williams Natural Gas Company, Williams Pipeline [sic] Company, WRC of Missouri, Inc., Agrico Chemical Company, Willco, Inc., Willbros Terminal Company and WRC of Crown Center, Inc. For simplicity, these companies will be referred to as Missouri subsidiaries.

tax return for the years 1982 through 1984. Because construction of the revenue laws of the state is involved, this Court has exclusive appellate jurisdiction. *Mo. Const. art. V, § 3.* The Court affirms the order of the Administrative Hearing Commission but remands for consideration of an issue not ruled.

The Williams Companies, Inc., is a Delaware corporation, domiciled in Oklahoma and parent to numerous subsidiaries engaged in a variety of activities, including the transportation and sale of petroleum products and natural gas and the operation of common carrier pipeline systems. From 1982 through 1984, several of these subsidiaries were qualified to do business in Missouri, including the seven joined in this action. These subsidiaries filed separate Missouri corporate income tax returns for those years. The Williams Companies, Inc., together with roughly forty affiliated and subsidiary companies, filed consolidated federal income tax returns.

In 1987, appellants filed consolidated amended Missouri corporate income tax returns for 1982 through 1984, accompanied by claims for refunds totalling $2,702,546. The Department of Revenue found appellants were not qualified to file consolidated returns under *§ 143.431.3(1), RSMo 1986,* and denied the refund claims. Appellants appealed to the Commission, claiming *inter alia,* that *§ 143.431.3(1)* is unconstitutional. The Commission upheld the denial of the claims without reaching the constitutional issue, which it is without authority to decide. *State Tax Commission v. Administrative Hearing Commission,* 641 S.W.2d 69 (Mo. banc 1982). This petition for review followed.

Missouri law permits the filing, of consolidated returns under the conditions specified in *§ 143.431.3(1):*

> If an affiliated group of corporations files a consolidated income tax return for the taxable year for federal income tax purposes and fifty percent or more of its income is derived from sources within the state as determined in accordance with ***section 143.451,*** then it may elect to file a Missouri consolidated income tax return. The federal consolidated taxable income of the electing affiliated group for the taxable year shall be its federal taxable income.

When an affiliated group files a consolidated federal return, but not a consolidated Missouri return, each member corporation that files in Missouri determines its "federal taxable income" for Missouri tax purposes as if it had filed a separate federal income tax return. *Section 143.431.3(4).* A corporation's Missouri taxable income is determined based upon its "federal taxable income." *Section 143.431.1, RSMo 1986.*

Appellants argue that *§ 143.431.3(1)* violates the Commerce Clause of the United States Constitution for two reasons: first, appellants and their affiliated companies constitute a unitary business, and only a consolidated return can accurately reflect the income that was earned in Missouri by the Missouri subsidiaries; second, the fifty percent "source of income" requirement of the statute discriminates against interstate commerce. Appellants also contend that the fifty percent "source of income" requirement violates the Uniformity and Equal Protection Clauses of the Missouri Constitution. *Mo. Const. art. X, § 3; art. I, § 2.*

In *Mid-America Television v. State Tax Commission*, 652 S.W.2d 674, 680-681 (Mo. banc 1983), *cert. denied*, 465 U.S. 1065, 104 S.Ct. 1413, 79 L.Ed.2d 740 (1984), this Court held that *§ 143.431.3(1)* does not violate the Uniformity and Equal Protection Clauses of the Missouri Constitution. That case is squarely on point and is dispositive of those issues. For reasons similar to those pointed out in *Mid-America*, 652 S.W.2d at 681, the Court concludes that *§ 143.431.3(1)* does not violate the Commerce Clause of the United States Constitution.

As a general principle, a state may not tax value earned outside its borders. *ASARCO, Inc. v. Idaho State Tax Commission*, 458 U.S. 307, 315, 102 S.Ct. 3103, 3108, 73 L.Ed.2d 787 (1982). Missouri's taxation scheme apportions the income of an interstate business by applying a statutory formula to its "federal taxable income." *§§ 143.431.1, 143.451, 32.200, RSMo 1986.*

The "linchpin" of state apportionment of income of an interstate business for income tax purposes is the unitary-business principle. *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U.S. 425, 439-440, 100 S.Ct. 1223, 1232-1233, 63 L.Ed.2d 510 (1980). The unitary-business principle defined the scope of an interstate business's activities that are subject to apportionment in terms of the relationship of those activities that occur outside the taxing state with those that occur within the state. The definition of "unitary business" may not be so broad as to "permit nondomicilliary States to apportion and tax dividends where the business activities of the dividend payor have nothing to do with the activities of the recipient in the taxing State." *ASARCO*, 458 U.S. at 327, 102 S.Ct. at

3115. Generally, a state income tax provision will withstand constitutional challenge under the Commerce Clause when it "is applied to an activity with a substantial nexus with the taxing state, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State." *Mobil*, 445 U.S. at 443, 100 S.Ct. at 1234, quoting *Complete Auto Transit v. Brady*, 430 U.S. 274, 279, 97 S.Ct. 1076, 1079, 51 L.Ed.2d 326 (1977).

The unitary-business concept is not monolithic. It may constitutionally encompass the lumping together of all income of a multicorporate conglomerate, or separate accounting respecting formal corporate lines. "There are variations on the theme, and any number of them are logically consistent with the underlying principles motivating the approach." *Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159, 167, 103 S.Ct. 2933, 2941, 77 L.Ed.2d 545 (1983). "The Constitution imposes no single formula on the states." *Container Corp.*, 463 U.S. at 164, 103 S.Ct. at 2939.

Formula apportionment and separate accounting are both "imperfect proxies for an ideal which is not only difficult to achieve in practice, but also difficult to describe in theory." *Container Corp.*, 463 U.S. at 182, 103 S.Ct. at 2949. The Missouri scheme strikes a course between the two. *Section 143.431.3* is fashioned on the principle that formula apportionment of the income of a unitary affiliated group is more likely to be "fairly apportioned, nondiscriminatory, sufficiently connected with the taxpayer's state activities, and fairly related to state benefits provided the taxpayer," *Mobil*, 445 U.S. at 443, 100

S.Ct. at 1234, when the affiliated group derives the majority of its income from in-state sources. Conversely, when the unitary group's income derives primarily from sources outside the state, formula apportionment of the income of only those subsidiaries with direct relationships to the State yields a corpus of income more reasonably related to the group's activities within the state. *Mid-America*, 652 S.W.2d at 680-681. This presupposes some coincidence between the economic and legal structures of the consolidated business, which may not exist in every case. *See Container Corp.*, 463 U.S. at 167-68, 103 S.Ct. at 2941-42. However, the legal form in which a taxpayer clothes its business is one of its own choosing. The fact that a form that is well suited to some purposes does not also minimize Missouri taxes does not violate the Commerce Clause of the United States Constitution.

In contrast to *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318, 97 S.Ct. 599, 50 L.Ed.2d 514 (1977) and *Westinghouse Electric Corporation v. Tully*, 466 U.S. 388, 104 S.Ct. 1856, 80 L.Ed.2d 388 (1984), cited by appellants, § *143.431.3* does not additionally tax appellants due to their interstate activities. Rather, the increased tax in this case results from the fact that the members of the group that generated losses and other tax savings are incorporated separately from the Missouri subsidiaries. Many of these subsidiaries did not file Missouri corporate income tax returns for the years in question. Disallowing consolidation of losses accrued outside Missouri with profits generated inside the State when there is no clear nexus between them (manifest by accruing under a single corporate franchise, or to a group deriving the majority of

income from sources within the State) does not discriminate against interstate commerce.

Appellants argue in the alternative that the Multistate Tax Compact, *§ 32.200,* requires or permits a combined return. Appellants distinguish combined returns from consolidated returns in that a consolidated return is based solely on the degree of ownership of a common parent, *I.R.C. §§ 1501, 1504 (1990),* whereas a combined return is based on the unitary nature of the affiliated group. To the extent that these concepts differ,[2] appellants' reading of *§ 32.200* would authorize the use of a different tax base than that specified in *§ 143.431, RSMo 1986.*[3] However, in *Goldberg v. State Tax Commission,* 639 S.W.2d 796, 799 (Mo.1982), this Court stated that the Multistate Tax Compact "was never intended by anyone to be a substantive taxation statute . . . [but] was conceived as merely a procedural vehicle by which the states could resolve conflicts among themselves and aggrieved taxpayers." The Compact does not impose a tax but merely computes the tax imposed. *See Dow Chemical Company v. Director of Revenue,* 787 S.W.2d 276 (Mo. banc 1990). *A fortiori,* the Compact was not intended to authorize an alternative tax base. Appellants' claim must fail.

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[2] As when a unitary business not filing a federal consolidated return seeks to file a combined return. *See* J.R. Hellerstein, *1 State Taxation: Corporate Income and Franchise Taxes,* n. 527, *§ 8.12* at 462 (1983).

[3] *Section 143.431.1, RSMo 1986,* provides that "The Missouri taxable income of a corporation taxable under *§§ 143.011 to 143.996* shall be so much of its *federal taxable income* for the taxable year . . . as is derived from sources within Missouri. . . . " (emphasis added).

Appellants also contest the Commission's finding that certain interest income of Williams Natural Gas Company and capital gain income of Williams Pipeline Company was apportionable as "business income" under the Multistate Tax Compact. The Williams Natural Gas Company income consisted of proceeds from short term loans made by Williams Natural Gas Company to its parent companies. The Williams Pipeline Company income consisted of proceeds from the sale of preferred stock it held in the Wood River Pipeline Company, a joint venture between it and Koch Industries, Inc., a refinery operator in Minnesota.

The Compact defines "business income" as:

> . . . income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations. *Section 32.200, art. IV 1(1), RSMo 1986.*

The Commission found that management of the funds that Williams Natural Gas Company loaned to its parent companies was not an integral part of its business. Appellants argue that because management of the funds was not an integral part of Williams Natural Gas' business, the interest thereon cannot be business income.

Business income includes, but is not limited to, income from "integral parts" of a taxpayer's business, but that is not the *sine qua non* of business income under the Compact. Rather, the test is whether the income is *"income from a unitary business." Dow Chemical,* 787 S.W.2d

at 283 (Mo. banc 1990) (emphasis in original); *James v. International Telephone and Telegraph Corporation*, 654 S.W.2d 865, 868 (Mo.banc 1983). The underlying activity, not the form of the investment, determines the propriety of apportionability, and dividends, interest income and capital gains are treated in the same manner for purposes of the unitary business principle. *James v. I.T.T.*, 654 S.W.2d at 868; *ASARCO*, 458 U.S. at 330, 102 S.Ct. at 3116; *Mobil*, 445 U.S. at 440, 100 S.Ct. at 1233.

Appellants admit that Williams Natural Gas and the parent company payors were parts of a unitary business. The interest income was thus from a unitary business and may be apportioned under the Multistate Tax Compact. Appellants argue that this inconsistently apportions interest income to Missouri while denying apportionment of corresponding deductions to the borrowing members of the unitary business. Such deductions will, however, be reflected on the Missouri income tax returns of the borrowing members, if they file them.

Appellants do not admit that Williams Pipeline Company's interest in the Wood River Pipeline Company venture was a part of its unitary business. However, undisputed facts support the finding. The Commission found that Williams Pipeline Company built a pipeline from Mason City, Iowa, to Pine Bend and Cottage Grove, Minnesota, where Koch Industries, Inc., operated refineries. Koch Industries, Inc., however, refused to commit to using a pipeline that it did not control. Subsequently, Williams Pipeline Company and Koch Industries, Inc., formed Wood River Pipeline Company, which Koch Industries, Inc., controlled. Williams Pipeline Company transferred the pipeline and various rights-of-way to

Wood River Pipeline Company in exchange for all of Wood River's preferred stock and the right to control in the event that preferred dividends were not paid within three years. Williams Pipeline Company also provided various maintenance, repair, and construction services to Wood River Pipeline company, albeit for compensation. The capital gain was realized when Williams Pipeline Company eventually sold its Wood River Pipeline Company stock to Koch Industries, Inc. Appellants do not dispute these facts, but argue that they are not sufficient to support the finding that Williams Pipeline Company's interest in Wood River Pipeline Company was a part of its unitary business.

In *Container Corp.*, 463 U.S. at 178, 103 S.Ct. at 2947, the Supreme Court stated that:

> When a corporation invests in a subsidiary that engages in the same line of work as itself, it becomes much more likely that one function of the investment is to make better use – either through economies of scale or through operational integration or sharing of expertise – of the parent's existing business-related resources.

Each of the benefits of the investment noted by the Court in *Container Corp.* is present in the case at bar. Similarly, the parent company in *Container Corp.*, 463 U.S. at 172, 103 S.Ct. at 2943, exercised little control over the day to day activities of the subsidiaries. Unlike *Philip Morris, Inc. v. Director of Revenue*, 760 S.W.2d 888, 891 (Mo. banc 1988), in which there was no exchange of expertise or information and no purchases or sales between the entities, Williams Pipeline Company contributed or sold substantial properties, services and expertise to Wood River Pipeline Company. Indeed, Wood River Pipeline Company owes

its very existence to Williams Pipeline Company's involvement in the enterprise. The undisputed facts adequately support the finding that Williams Pipeline Company's interest in Wood River Pipeline Company was a part of Williams Pipeline Company's unitary business. The capital gain realized by Williams Pipeline Company on its sale of the Wood River Pipeline Company preferred shares therefore is apportionable under § 32.200. It is unnecessary to reach the question of whether certain other findings of fact that appellants dispute are supported by the record.

The final order of the Department of Revenue assessed a five percent addition to the tax due pursuant to § *143.751(a)*, RSMo 1986, which provides for such "If any part of a deficiency is due to negligence or intentional disregard of the rules and regulations (but without intent to defraud)." Appellants maintain that the deficiency assessed did not result from negligence or intentional disregard of the rules. Although appellants properly raised this issue before the Commission, the decision of the Commission fails to address it. Accordingly, the case is remanded to the Administrative Hearing Commission for consideration of this single issue alone. Except for that part of the order assessing the five percent addition, the order of the Administrative Hearing Commission is affirmed; the case is remanded for resolution of the addition to the deficiency pursuant to § *143.751(1)*.

All concur.

CLERK OF THE SUPREME COURT
STATE OF MISSOURI
POST OFFICE BOX 150
JEFFERSON CITY, MISSOURI
THOMAS F. SIMON 65102 TELEPHONE
CLERK (314) 751-4144

December 18, 1990

Mr. J. Kent Lowry
P.O. Box 1069
Jefferson City, MO 65102

Mr. Henry G. Will
2400 First National Tower
Tulsa, Oklahoma 74103

In re: The Williams Companies, Inc., etc., et al. vs.
Director of Revenue
Supreme Court No. 72352

Dear Counsel:

Please be advised that the Court this day entered the following order in the above-entitled cause:

"Appellants' motion for rehearing overruled."

Very truly yours,

THOMAS F. SIMON

/s/ Mary Elizabeth McHaney
Mary Elizabeth McHaney
Deputy Clerk, Court en Banc

cc: Mr. Richard Weiler
Mr. George Cox
Mr. Ronald J. Miller

Before the
Administrative Hearing Commission
State of Missouri

(SEAL)

THE WILLIAMS COMPANIES, INC., AND ITS DOMESTIC SUBSIDIARIES, INCLUDING WILLIAMS NATURAL GAS COMPANY, WILLIAMS PIPE LINE COMPANY, WRC OF MISSOURI, INC., AGRICO CHEMICAL COMPANY, WILLCO, INC. (EDGCOMB METALS COMPANY), WILLBROS TERMINAL COMPANY, AND WRC OF CROWN CENTER, INC.,	)	Case No. 88-000363RI
Petitioners,	)	
vs.	)	
DIRECTOR OF REVENUE, STATE OF MISSOURI,	)	
Respondent.	)	

FINDINGS OF FACT AND CONCLUSIONS OF LAW

The Williams Companies, Inc., and its domestic subsidiaries, including Williams Natural Gas Company, Williams Pipe Line Company, WRC of Missouri, Inc., Agrico Chemical Company, Willco, Inc. (formerly Edgcomb Metals Company), Willbros Terminal Company, and WRC of Crown Center, Inc., filed a complaint on March 23, 1988, and amended it on August 12, 1988, seeking this Commission's determination that the Director of Revenue erroneously assessed deficiencies of corporate income tax and denied refund claims for 1982 through 1984. The Petitioners claim that substantial refunds are due to them

because of consolidated amended returns filed on a combined reporting basis. They also complain that the Director assessed deficiencies against Williams Natural Gas Company on interest income and against Williams Pipe Line Company on capital gains income which they contend were not items of income taxable in Missouri.

This Commission held a hearing on November 23, 1988, at the Truman State Office Building, Jefferson City, Missouri. Henry G. Will, an attorney with Connor & Winters of Tulsa, Oklahoma, and J. Kent Lowry, an attorney with Hendren & Andrae of Jefferson City, Missouri, represented the Petitioners. Barbara Hoppe, the Director's assistant general counsel, represented the Director. This Commission granted the parties' request to file written arguments under § 536.080.1, RSMo 1986.[1] The parties filed the Third Set of Partial Stipulations of Fact on November 14, 1989.

Findings of Fact

We base these findings on the pleadings, including the Director's Final Decision, the Stipulation of Facts filed on October 4, 1988, the Second Set of Partial Stipulations of Facts, with 51 joint exhibits, filed on November 23, 1988, the Third Set of Partial Stipulations of Fact, with 48 pages of unmarked exhibits, filed on November 14, 1989, the Petitioners' responses to the Director's first, third and fourth sets of interrogatories, of which we take notice as requested by the Director, and the evidence received at

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[1] All statutory references herein, unless otherwise noted, are to the Revised Statutes of Missouri, revision of 1986.

hearing. All of the findings apply to all of the years at issue unless otherwise noted.

1. Williams was a Delaware corporation whose headquarters were in Tulsa, Oklahoma. It was a publicly-owned holding company which engaged in a variety of activities for profit through approximately 90 corporate subsidiaries and affiliates, including the transportation and sale of petroleum products, natural gas, and natural gas products, and operation of common carrier pipeline systems.

2. Williams Natural Gas Company (WNG) was a Delaware corporation whose headquarters were in Tulsa, Oklahoma. It was a wholesale supplier of natural gas and operated in Wyoming, Texas, Kansas, Oklahoma, Missouri and Nebraska. It provided natural gas to industrial plants, public utilities, and municipalities.

3. Prior to October 8, 1983, WNG was named Northwest Central Pipeline Company and was a wholly-owned subsidiary of Northwest Energy Company (Northwest Energy), a Utah corporation and holding company which engaged through subsidiaries in exploring, producing, transmitting, purchasing and selling natural gas, natural gas products and petroleum. On October 8, 1983, WNG became an indirect, wholly-owned subsidiary of Williams when Williams purchased all of Northwest Energy's stock. Northwest Central Pipeline Company functioned for some time as a subsidiary of Williams under the name Northwest Central Pipeline Company. At the time of Williams' acquisition of Northwest Central, another subsidiary of Williams was operating in Louisiana as Williams Natural Gas Company. The record does not show

the relationship, if any, of Northwest Central and the original Williams Natural Gas Company, and it does not reveal the eventual fate of the latter.

4. Prior to November 13, 1982, WNG was named Cities Service Gas Company and was a wholly-owned subsidiary of Cities Service Company. Cities Service Company explored, produced and marketed petroleum and petroleum products, including natural gas, metals, petrochemicals and other chemicals. Northwest Energy purchased WNG from Occidental Petroleum Company when Occidental acquired WNG's parent, Cities Service Company.

5. Williams Pipe Line Company (WPL), a wholly-owned subsidiary of Williams, was a Delaware corporation whose headquarters were in Tulsa, Oklahoma. WPL was a regulated, common carrier pipeline which operated in 12 states, including Missouri. WPL operated terminals in Springfield, Missouri, and Columbia, Missouri, for distributing petroleum products, including crude oil, liquefied natural gas, and fertilizer solutions.

6. WRC of Missouri, Inc. (WRC), was a Delaware corporation domiciled in Missouri and was a wholly-owned subsidiary of Williams Real Estate Corporation, which was a wholly-owned subsidiary of Williams. During 1982 through 1984, WRC was in the business of holding and managing real estate located in Missouri. WRC ceased operations in Missouri on March 30, 1984.

7. Agrico Chemical Company, Inc. (Agrico), was a Delaware corporation and a wholly-owned subsidiary of Williams whose principal place of business was in Tulsa, Oklahoma. Agrico manufactured and marketed nitrogen

and phosphate fertilizers. It operated four large domestic chemical fertilizer manufacturing complexes and marketed fertilizers in the eastern two-thirds of the United States. Agrico operated in Missouri during 1982 through 1984.

8. Willco, Inc. (Willco), was a Delaware corporation whose principal place of business was in Tulsa, Oklahoma. It was a wholly-owned subsidiary of Williams and was formerly known as Edgcomb Metals, Inc., and operated under that name as a manufacturer and distributor of metals. As Edgcomb, Willco operated in Missouri during 1982 through 1984. In 1984, Williams sold the assets, business and name "Edgcomb Metals." The corporation, renamed Willco, was inactive following the sale.

9. Willbros Terminal Company, Inc. (Willbros), was a wholly-owned subsidiary of WPL. It was a Delaware corporation whose principal place of business was in Tulsa, Oklahoma. Willbros operated WPL's terminals at Columbia, Missouri, and Springfield, Missouri, during 1982 through 1984.

10. WRC of Crown Center, Inc. (Crown), was a wholly-owned subsidiary of Williams Realty Developments, Inc., a wholly-owned subsidiary of Williams Real Estate Corporation which was, in turn, a wholly-owned subsidiary of Williams. Crown was a Delaware corporation whose principal place of business was in Missouri. During 1982 and 1984, Crown held and managed real estate at Crown Center in Kansas City, Missouri.

11. Williams and its domestic and foreign subsidiaries, including Northwest Energy after Williams' acquisition of it on October 8, 1983, and its domestic and

foreign subsidiaries, were bound to one another by centralized management and vertical and horizontal integration which produced economies of scale and transfers of value within the group of companies.

12. Northwest Energy and its domestic and foreign subsidiaries, including Northwest Central Pipeline and each of its affiliates, were bound to one another by centralized management and vertical and horizontal integration which produced economies of scale and transfers of value within that group of companies.

13. Williams and its subsidiaries shared common officers and directors. Williams controlled its subsidiaries' boards of directors and intercompany dividends. Williams commingled the dividends with its operating funds. It reviewed, with the power to reject, all of its subsidiaries' budgets and major contracts. Williams and the subsidiaries shared some facilities including offices in Tulsa, Oklahoma, and Salt Lake City, Utah, a data processing system, a communications network, internal auditing, planning data, transportation facilities, central bank facilities, and legal and accounting firms. Williams provided some services to its subsidiaries including central purchasing of office supplies and equipment, preparation of payroll and accounting reports, preparation of tax returns, and insurance maintenance and administration. Williams and the subsidiaries had common group insurance plans, pension plans, and personnel policies and procedures. The companies frequently transferred employees from one company to another.

14. Northwest Energy and its subsidiaries had the same officers and directors. Northwest Energy controlled

its subsidiaries' boards of directors and intercompany dividends. Northwest Energy commingled the dividends with its operating funds. Northwest Energy reviewed, with the right to reject, its subsidiaries' budgets and major contracts. Northwest Energy and its subsidiaries shared some facilities such as offices, a data processing system, internal auditing, planning data, transportation facilities, central bank facilities, and legal and accounting firms. Northwest Energy provided its subsidiaries with purchasing of office supplies and equipment, preparation of payroll and accounting reports, preparation of tax returns, and insurance maintenance and administration. Northwest Energy and its subsidiaries shared common group insurance plans, pension plans, and personnel policies and procedures. The companies frequently transferred employees from one company to another within the group.

The Refund Claims

15. Williams and its domestic subsidiaries filed consolidated federal income tax returns for 1982 through 1984. Northwest Energy and its domestic subsidiaries filed consolidated federal income tax returns for 1982 and 1983. Neither Williams and its domestic subsidiaries nor Northwest Energy and its domestic subsidiaries ever derived 50 percent or more of its income from Missouri sources during any of these years.

16. Each of Williams' and Northwest Energy's subsidiaries which operated in Missouri during those years filed separate Missouri corporate income tax returns for each year it operated in Missouri. Where the returns

indicated a tax debt, the firms paid that amount. The Petitioners elected the multistate allocation and three-factor apportionment procedures allowed in the Multistate Tax Compact, codified at § 32.200, RSMo.

17. On January 6, 1987, Williams sent a letter to the Director on behalf of its Missouri subsidiaries, informing him that Williams and the other Petitioners believed they were entitled to file consolidated Missouri corporate income tax returns on the basis of combined reporting. On January 26, 1987, the Petitioners filed consolidated amended Missouri corporate income tax returns for 1982 through 1983 based on combined reporting. Accompanying the amended returns were refund clams amounting to $2,808,763. The Petitioners never sought or obtained the Director's permission to file consolidated amended returns on a combined reporting basis. The corporations included in the consolidated amended returns did not submit authorization and consent forms to the Director until March, 1988. No authorization and consent forms for prior years were ever submitted to the Director.

Northwest Central Pipeline & Affiliated Companies – Amended Returns and Claims for Refund

FYE	Amount
11/12/82	$ 106,217
12/31/82	211,127
10/07/83	923,002
Total:	$1,240,346

The Williams Companies & Subsidiaries – Amended Returns and Claims for Refund

FYE	Amount
1982	$ 184,732
1983	592,313
1984	791,372
Total:	$1,568,417
Grand Total:	$2,808,763

The Petitioners have withdrawn their claim for refund for Northwest Central Pipeline and its affiliated companies for their fiscal year ending on November 12, 1982. The adjusted grand total of the refund claims is $2,702,546.

18. The federal taxable income shown on Line No. 1 of the consolidated amended Missouri returns was the two company groups' consolidated taxable income. In each case, the return was calculated on a "water's edge" combined reporting basis and foreign subsidiaries and affiliates were excluded. They treated their losses and intercompany transactions the same in their consolidated amended Missouri returns as they did in the federal consolidated returns. They based their treatment of losses and intercompany transactions on regulations of the Internal Revenue Service of the United States Treasury Department. They included their subsidiaries' and affiliates' net operating losses in their federal consolidated returns to determine the federal taxable income on their consolidated amended Missouri returns. They included in the federal taxable income reported on their consolidated amended Missouri returns net operating losses that would have been carried back three years or forward 15

years on the separate return for each subsidiary had it filed a separate return.

19. Northwest Exploration Company, Inc., Williams Gas Marketing Company, Inc., Williams Realty Developments, Inc., and WRC of St. Louis, Inc., were wholly-owned subsidiaries of Williams which operated in Missouri during 1982 through 1984. Each filed a separate Missouri corporate income tax return for 1982 through 1984 but did not owe corporate income tax to Missouri for those years. The income of each was included in one or more of Williams' and Northwest Energy's consolidated amended Missouri returns.

The WNG Interest Income

20. The Director assessed additional income tax against WNG for interest income which WNG had characterized in its returns as non-business, non-Missouri source, investment income. WNG earned this interest from loans to its corporate parents and short-term securities. The lowest daily balances posted for these accounts during the months at issue were:

CITIES SERVICE COMPANY FINANCE ACCOUNT

Year – 1982	Lowest Daily Balance
January	$ 3,323,911
February	17,317,141
March	106,398,566
April	144,186,700
May	153,449,630
June	99,231,036
July	75,487,625
August	51,794,301
September	4,493,463
October	7,221,652
November	0

NORTHWEST ENERGY COMPANY FINANCE ACCOUNT

Year – 1982	Lowest Daily Balance
December	$30,000,000

Year – 1983	Lowest Daily Balance
January	$ 30,000,000
February	45,586,250
March	124,518,264
April	139,000,000
May	151,339,829
June	185,637,438
July	166,560,000
August	168,249,438
September	132,413,822
October	126,400,000
November	127,707,387
December	105,210,099

Year – 1984	Lowest Daily Balance
January	$ 97,970,359
February	161,192,842
March	239,328,250
April	235,692,788
May	257,105,844
June	224,194,147
July	197,650,467
August	165,203,692
September	146,963,075

THE WILLIAMS COMPANIES FINANCE ACCOUNT

Year – 1984	Lowest Daily Balance
October	$ 64,118,334
November	56,305,229
December	54,190,295

Year – 1985	Lowest Daily Balance
January	$ 54,607,639
February	102,868,504
March	154,769,398
April	185,756,708
May	182,370,841
June	181,921,962
July	156,531,479
August	137,561,971
September	112,738,683
October	96,728,750
November	94,114,592
December	88,488,502

"SHORT TERM INVESTMENT PORTFOLIO"

Year – 1982	Lowest Daily Balance
November	$4,100,000
December	500,000

Year – 1983	Lowest Daily Balance
January	$8,000,000
February	4,400,000
March	5,500,000
April	3,100,000
May	8,500,000
June	7,400,000
July	7,800,000
August	6,200,000
September	3,400,000
October	900,000
November	1,800,000

21. The amounts deposited into and withdrawn from these accounts for each of the months at issue were:

MONTHLY DEPOSITS AND WITHDRAWALS IN ACCOUNTS CALENDAR YEARS 1982 AND 1983

Calendar Year 1982

Month	Amounts Deposited	Amounts Withdrawn	Average Monthly Balance
January	$123,115,129	$107,328,960	$ 32,978,699
February	178,867,023	190,869,570	163,584,020
March*	175,692,022	190,869,570	163,584,020
April	108,911,431	96,120,860	172,035,605
May	84,214,040	81,245,341	174,211,984
June*	55,479,129	111,530,922	156,318,692
July*	57,668,612	81,412,023	109,551,371
August*	46,006,525	69,699,848	82,411,716
September*	42,800,514	90,111,353	49,815,880
October	66,352,970	60,961,934	17,740,109
November	132,732,872	129,107,370	17,114,257
December	133,105,417	104,900,000	40,118,919

Calendar Year 1983

Month	Amounts Deposited	Amounts Withdrawn	Average Monthly Balance
January	$228,585,833	$200,505,417	$ 97,887,904
February	175,032,431	67,800,000	122,635,615
March*	121,411,375	138,329,639	172,798,943
April	118,079,829	108,440,000	182,425,156
May	158,144,359	107,700,000	209,881,840
June*	54,858,250	80,500,000	226,005,261
July*	59,089,438	72,177,438	198,621,465
August*	48,139,417	51,600,000	186,613,170
September*	57,924,967	96,300,000	179,299,338
October*	60,747,387	64,353,822	144,714,027
November	60,773,250	50,600,000	146,774,266
December*	65,024,794	104,545,538	155,100,304

Calendar Year 1984

Month	Amounts Deposited	Amounts Withdrawn	Average Monthly Balance
January	$139,284,442	$ 78,636,820	$149,770,401
February	168,210,790	78,136,831	226,384,801
March*	86,311,078	101,701,773	278,367,297
April	104,720,777	81,140,900	274,409,352
May	86,739,702	67,172,283	289,125,492
June*	42,554,740	103,498,668	272,020,914
July*	57,500,001	84,043,681	224,042,388
August*	41,804,872	74,251,647	197,788,045
September*	44,024,668	62,265,284	165,484,652
October*	42,430,761	125,275,502	93,393,389
November*	60,001,767	66,336,841	70,896,289
December*	90,494,211	92,521,567	85,929,127

Calendar Year 1985

Month	Amounts Deposited	Amounts Withdrawn	Average Monthly Balance
January	$149,365,000	$ 94,706,573	$112,947,609
February	140,221,205	76,124,074	152,333,552
March	154,328,032	131,724,727	203,211,401
April*	77,760,475	82,509,451	206,544,283
May	69,584,587	68,731,257	206,649,143
June*	42,857,233	54,154,393	200,466,851
July*	43,842,099	69,232,583	178,542,778
August*	58,879,074	77,848,581	160,190,243
September*	39,397,125	64,220,413	138,535,396
October*	38,351,199	54,361,132	115,459,224
November	48,181,230	47,869,710	106,870,413
December*	79,704,655	84,469,077	112,613,561

*Months in which withdrawals exceeded deposits.

22. The money which WNG used for the loans and investments came from its general business bank accounts and was primarily cash from its natural gas

sales. Approximately 45 percent of this cash came from Missouri sources. WNG typically did not need this money for its operations for 10 days; it was the "float." WNG withdrew or deposited the money into revolving accounts every business day. Often, WNG's withdrawals exceeded its deposits in these accounts during a given month. Sometimes WNG used this money for paying payroll, taxes, dividends, debt service, capital improvements and current obligations.

23. WNG reported the invested funds in its financial statements as current assets – as notes receivable or as temporary cash investments. The financial statements were available to the public and to companies from whom WNG obtained bonds, loans and insurance. Management of this money was not an integral part of WNG's business. WNG claimed these interest expenses on its federal tax returns:

Year	Interest Expense
FYE 1982	$22,044,952
FYE 1983	$20,051,296
FYE 1984	$22,662,395
FYE 1985	$18,470,060

24. WNG loaned money to its corporate parents. WNG obtained payable-on-demand promissory notes from them and earned interest on the loans. The parents used the money for intercompany loans and investments. The interest earned by WNG was:

Cities Service Company	1982	$12,185,349
Northwest Energy Company	1982	105,416
Northwest Energy Company	1983	16,891,329
Northwest Energy Company	1984	21,127,285
The Williams Companies, Inc.	1984	2,522,024
The Williams Companies, Inc.	1985	16,017,158

25. WNG used money it did not need for current operations for short-term investments in repos for one to 10 days.

26. On October 14, 1986, WNG, in writing and for consideration, extended to November 30, 1986, the deadline for the Director's mailing of deficiency notices to WNG for 1982.

The Wood River Pipeline Shares

27. WPL began transporting crude oil by pipeline in 1973 to refineries in the "northern tier" states, primarily to Minnesota. WPL used existing lines between El Dorado, Kansas, and Bethany, Missouri, and between Mason City, Iowa, and Pine Bend or Cottage Grove, Minnesota.

28. In response to the announced phase-out of Canadian crude oil supplies in the northern tier region, WPL constructed, at a cost of $37 million, an 18-inch pipeline from Mason City, Iowa, to Pine Bend and Cottage Grove, Minnesota; a 16-inch pipeline from El Dorado, Kansas, to Des Moines, Iowa; and a 12-inch pipeline from Des Moines, Iowa, to Mason City, Iowa. WPL also increased the horsepower of the pumping stations on its existing lines.

29. Koch Industries, Inc., the operator of refineries at Pine Bend and Cottage Grove, Minnesota, refused to commit to using the pipeline, placing WPL's $37 million investment at risk. Koch planned to construct its own pipeline but was unable to do so because it could not procure an Iowa right-of-way. Iowa authorities refused the right-of-way request after environmental hearings

where WPL employees, among others, testified against Koch's pipeline plans.

30. In 1980, WPL entered into a joint venture with Koch, known as Wood River Pipeline Corporation (Wood River), to construct and operate the Gulf Coast-Northern Tier Pipeline. By an agreement executed on June 19, 1980, WPL transferred its 18-inch Mason City-Pine Bend and Cottage Grove pipeline and easements in pipeline rights-of-way between Bethany, Missouri, and Mason City, Iowa, to Wood River in exchange for all of Wood River's preferred stock. Koch agreed to construct a pipeline on the Bethany-Mason City right-of-way and from Wood River, Illinois, to Bethany, Missouri. Koch received all of Wood River's common stock. Koch elected four of Wood River's five directors. Control of Wood River was to transfer to WPL if Wood River did not pay a dividend on the preferred shares within three years of the dividend's declaration date – an event which never occurred.

31. The agreement authorized WPL to provide certain construction-related services during the construction of the Bethany-Mason City pipeline, including surveying, permits and licenses, and interconnections. WPL provided and analyzed aerial photographs; changed the pipeline route using stereo studies and field reconnaissance; obtained route profile data; prepared field alignment maps, topographic maps and permit drawings; prepared property plats and conducted many surveys and related functions. WPL and Koch had to approve any "abnormal" costs for these services. Wood River used equipment belonging to WPL for constructing the Bethany-Mason City pipeline.

32. WPL agreed to perform inspections, repairs and maintenance for Wood River on the Bethany-Mason City and Mason City-Pine Bend and Cottage Grove pipelines for money according to a schedule. WPL received more than just money for these services: They reduced maintenance costs and overhead.

33. The June 1980 agreement also required Wood River to make a temporary connection to WPL's pipeline so WPL and other carriers could comply with established joint tariffs until WPL could build its own spur pipeline. WPL paid market rates for using Wood River's line. Between December 1981 and May 1982, WPL shipped crude oil in Wood River's line to Ashland Petroleum and paid Wood River $233,718.54 rent for these shipments. This was WPL's only use of Wood River's line; Wood River never used WPL's line. WPL completed its spur line in May 1982 and did not use Wood River's line after then.

34. Koch made the agreement to assure that it had a crude oil supply.

35. WPL retained title in the Bethany-Mason City and Mason City-Pine Bend and Cottage Grove pipeline rights-of-way. WPL included the value of these rights-of-way in the property factor on its Missouri corporate income tax returns. WPL deleted the value of the Mason City-Pine Bend and Cottage Grove pipeline and the Bethany-Mason City easements from the property factor in its corporate income tax returns after 1979.

36. WPL and Wood River had different officers, directors and employees. Koch, not WPL, supplied management and administrative services to Wood River. WPL appointed one Wood River board member who also was

an officer and director of Williams, WPL's corporate parent.

37. Wood River appointed WPL as its agent to pay local taxes, leases and fees, to keep property records, and to settle landowner disputes. WPL insisted on this to protect the value of its rights-of-way, its most valuable assets. Wood River reimbursed WPL for expenses related to these services only if it had approved before being incurred.

38. WPL managed the day-to-day affairs of the Bethany-Mason City and Mason City-Pine Bend and Cottage Grove pipelines. These services were the same as those WPL performed for its own pipelines in the Bethany-Mason City and Mason City-Pine Bend and Cottage Grove rights-of-way. These services included repairing system leaks and breaks; opening and closing valves; operating system motors and pumps; operating scraper traps; handling scrapers and pigs; monitoring the cathodic protection system; proving meters; patrolling the line; repairing stations; preventive maintenance and routine maintenance checks.

39. WPL and Wood River did not share pumping stations, terminals, structures, equipment or other facilities on any portion of the Wood River pipeline. WPL and Wood River both used the Bethany-Mason City and Mason City-Pine Bend and Cottage Grove rights-of-way.

40. Wood River paid WPL $1,307,649 in 1980, $1,865,290 in 1981, $314,428 in 1982, and less than $10,000 a year after 1982.

41. Declining demand for crude oil caused Wood River's revenues to decline. This hampered Wood River's paying WPL preferred dividends and threatened to shift control of Wood River from Koch to WPL. WPL sold all of its Wood River stock to Koch for $26 million on January 5, 1984, a capital gain of approximately $9.5 million. WPL placed the capital gain into its general business accounts with its other money.

42. Prior to investing in Wood River, WPL did not regularly acquire stock. While WPL had part ownership in Wood River, it did not have any ownership in any other company.

43. WPL reported its $9.5 million capital gain income as non-business income on its original separate Missouri return and on the consolidated amended Missouri return.

44. The Director assessed $95,608.08 in additional taxes against WPL for the Wood River stock sale.

Conclusions of Law

I

Williams and the other Petitioners maintain that, as a unitary business, they were entitled to report their Missouri corporate income on a combined or consolidated basis. This would result in Petitioners' paying less tax, primarily because their reported income would not include transfers within the affiliated group. The Director contends that the Petitioners could not file consolidated returns because less than 50 percent of their income was from Missouri sources and that Missouri statutes do not

authorize combined reporting. He further contends that even if consolidated or combined reporting were permitted, Petitioners could not do so in this case because they first elected to report separately.

Sections 143.071 and 143.431.1 impose an income tax on "so much of [a corporation's] federal taxable income . . . as is derived from sources within Missouri as provided in section 143.451." Williams and the other Petitioners contend that Missouri law arguably requires – but at least does not prohibit – combined reporting for taxpayers in their situation. They point to § 32.200, Art. IV § 9 (the Multistate Tax Compact) which provides. "All business income shall be apportioned to this state by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three." The argue that only combined reporting and consolidated returns permit a unitary business to calculate accurately its taxable activity in Missouri.

The Petitioners cite several cases from other Compact states which hold that the Compact requires or encourages combined reporting, and contend that these decisions are authoritative because the Compact is a uniform law. They assert that we should give these cases the same effect as the Missouri Court of Appeals gave to other states' cases construing the Uniform Arbitration Act. The court stated, in *State ex rel. Tri-City Construction Company v. Marsh*, 668 S.W.2d 148, 151 (Mo. App., W.D. 1984), "In the absence of any Missouri Authority and without any compelling policy to overcome the need for uniformity, the statute should be construed as other states have construed it in their decisional law."

Williams and the other Petitioners attempt to distinguish between consolidated returns and combined reporting: Consolidated returns permit affiliated corporations linked by a statutorily-set degree of common ownership to file returns and to pay taxes as a single entity; combined reporting accurately determines the state tax liability of an affiliated group constituting a unitary business. Petitioners' Brief at 25-26. Missouri law permits consolidated returns under the conditions described in § 143.431.3:

> (1) If an affiliated group of corporations files a consolidated income tax return for the taxable year for federal income tax purposes and fifty percent or more of its income is derived from sources within the state as determined in accordance with section 143.451, then it may elect to file a Missouri consolidated income tax return. The federal consolidated taxable income of the electing affiliated group for the taxable year shall be its federal taxable income.
>
> * * *
>
> (4) For each taxable year an affiliated group of corporations filing a federal consolidated income tax return does not file a Missouri consolidated income tax return, for purposes of computing the Missouri income tax, the federal taxable income of each member of the affiliated group shall be determined as if a separate federal income tax return had been filed by each such member.

Petitioners did not satisfy the 50 percent threshold, and they filed their original, separate returns pursuant to § 143.431.3(4). Petitioners argue that, despite § 143.431.3,

they may use combined reporting because (1) a consolidated return is not the same as combined reporting and, therefore, § 143.431.3 is inapplicable, and (2) the Compact mandates, or at least permits, combined reporting. We disagree.

We agree with the Director's contention that no more than a single taxpayer may appear on a single return unless either the requirements of § 143.431.3(1) are met or the taxpayers have first sought and received the Director's permission. Otherwise, the conditions and limitations established by § 143.431.3(1) would be pointless, and we do not presume the legislature to have enacted a meaningless provision. *State v. Bachman*, 675 S.W.2d 41, 45 (Mo. App., W.D. 1984).

Section 143.431.1 plainly speaks of "[t]he Missouri taxable income of *a* corporation . . . " (emphasis added). Petitioners maintain that we should not attach any significance to the legislature's writing the statute in the singular. They contend that this statute "merely sets a standard that Missouri will not tax income earned beyond its borders." Petitioners' Brief at 29. We do attach significance to the statute's being written in the singular; we conclude that the legislature contemplated only one corporation filing on a return.

We find nothing in the Compact requiring combined reporting or consolidated returns. The non-Missouri cases cited by the Petitioners are not persuasive or "authoritative."[2] In fact, Missouri has unmistakably limited the

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[2] The Uniform Arbitration Act construed in *Tri-City Construction, supra*, contains a command, absent from the Compact, that the act be construed uniformly with the decisional law of other enacting states. Section 435.450; *Tri-City Construction* at 151.

effect of the Compact to the calculation option that its plain language provides: "The Compact was never intended by anyone to be a substantive taxation statute. . . . The drafters of the Compact and those states that adopted it never intended for it to have a substantive effect on taxation. That was not its purpose." *Goldberg v. State Tax Commission*, 639 S.W.2d 796, 799-800 (Mo. 1982).

Certainly, both combined reporting and consolidated returns are potentially available to Williams, for the Director is vested with broad discretion to allow – or require – whatever means of reporting best reflects the taxpayer's tax liability under the circumstances. As the Petitioners acknowledge, Petitioners' Brief at 29-30, the Compact provides that "the taxpayer may petition for . . . if reasonable: . . . (4) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income." Section 32.200, art. IV, § 18(4); *compare* § 143.461.2.

However, that permission must be sought and received *before* a return is filed for a given tax year. Once a taxpayer has elected to file on a particular basis, that election is irrevocable. *Bartlett & Company Grain v. Director of Revenue*, 649 S.W.2d 220 (Mo. 1983). The Director cannot be compelled – and may lack authority – to permit taxpayers to avoid the adverse effects of their own lack of foresight by the belated amendment of their returns.

The Petitioners also attack § 143.431.3(1) on constitutional grounds. They contend that the limitation of consolidated returns to those groups which derived 50 percent or more of their income from Missouri sources

violates the Commerce Clause of the United States Constitution and the equal protection and uniform taxation requirements of the Missouri Constitution. As to the latter claim, we point out that the Missouri Supreme Court, in *Mid-America Television Co. v. State Tax Commission*, 652 S.W.2d 674, 679-81 (Mo. banc 1983), determined that § 143.431.3(1) did not violate the equal protection and uniform taxation provisions. As to the Commerce Clause, we remind the Petitioners that this Commission does not have authority to consider a constitutional challenge to a statute. *City of Joplin v. Industrial Commission of Missouri*, 329 S.W.2d 687 (Mo. banc 1959); *State Tax Commission v. Administrative Hearing Commission*, 641 S.W.2d 69 (Mo. banc 1982).

We conclude that the Director properly denied the refund claims.

II

The remaining two issues in this case concern categories of income which Williams and the other Petitioners contend are not taxable in Missouri. WNG earned interest income by investing its excess cash. WPL earned capital gains income by selling its stock in Wood River. Neither WNG nor WPL was a Missouri corporation or had its headquarters in Missouri. Because the income was not earned in Missouri, neither corporation reported it as taxable on its Missouri tax returns. Instead, WNG and WPL allocated the income entirely to their home states for tax purposes.

Williams and the other Petitioners contend that WNG's interest income and WPL's capital gains income

are not taxable in Missouri because they are not business income which the Compact defines as "income arising from transactions and activity in the regular course of the taxpayer's trade or business. . . . " Section 32.200, art. IV, § 1(1). WNG and WPL argue that these items were not business income because the activities that produced them were not part of their respective businesses of producing, transporting and marketing natural gas, and operating common carrier pipelines. WNG and WPL maintain that, under the Compact's allocation rules for non-Missouri source, non-business income of non-domiciliary corporations, they were not taxable by Missouri at all.

We conclude that Williams and the other Petitioners have mischaracterized the income as non-business income. The Commerce and the Due Process clauses of the United States Constitution prohibit a state from imposing an income-based tax upon "value earned outside its borders." *Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159, 164 (1983); *ASARCO, Inc. v. Idaho State Tax Commission*, 458 U.S. 307, 315 (1982); *Phillip Morris, Inc. v. Director of Revenue*, 760 S.W.2d 888, 889 n.1 (Mo. banc 1988). Missouri cannot tax income arising from interstate business unless sufficient connections exist between it and the interstate activities and there is a "rational relationship between the income attributed to the State and the intrastate values of the enterprise." *Container Corporation, supra*, at 165-166; *Exxon Corporation v. Wisconsin Department of Revenue*, 447 U.S. 207, 219-220 (1980); *Mobile Oil Corporation v. Commissioner of Taxes of Vermont*, 445 U.S. 425, 436, 437 (1980).

Where, however, a corporation's in-state and out-of-state activities form a unitary business, geographic

accounting, while purporting to isolate income received in various states, "may fail to account for contributions to income resulting from function integration, centralization of management, and economies of scale." *ASARCO, supra,* at 317; *Mobil, supra,* at 438. In such cases, formulary apportionment should be used to determine a unitary business' income attributed to a given jurisdiction. This formula should be derived from objective measures of the business' activities within the taxing state. *Container Corporation, supra,* at 165.

The United States Supreme Court has asserted repeatedly that, in the case of a non-domiciliary, multi-jurisdictional business enterprise, "[t]he linchpin of apportionability in the field of state income taxation is the *unitary business principle.*" *ASARCO, supra,* at 317 (emphasis added). The Court has emphasized that "formulary apportionment . . . is constitutionally permissible only in the case of a unitary business." *ASARCO, supra,* at 320, n. 14 (*quoting* Rudolph, *State Taxation of Interstate Business: The Unitary Business Concept and Affiliated Corporate Groups,* 25 Tax. L. Rev. 171, 181 (1970)). Thus, the unitary business principle is intimately and inevitably concerned in every case of state income taxation of multi-jurisdictional corporate activities regardless of the source or nature of the particular formula employed.

The first step in apportionment is defining the unitary business' scope. *Container Corporation, supra,* at 165. Only income derived from the unitary business' operations is subject to formulary apportionment; the other income – non-unitary business income – must be excluded from apportionment and separately analyzed.

This distinction has been built into the Compact's apportionment and allocation rules which categorize income as business or non-business income as the first step in the attribution process. Thus, "business income" under the Compact is equivalent to "unitary business income"; the purpose and effect is to exert Missouri's taxing power under the Compact to the very limits of constitutionality and no farther. *See Dow Chemical Company v. Director of Revenue*, No. 71010, slip op. at 7-8 (Mo. banc 1989); *Phillip Morris, supra.*

To be constitutionally acceptable, an apportionment formula must be fair. *Container Corporation, supra*, at 169. To be fair, it must be internally consistent so that its application by every jurisdiction would result in no more than all of the income being taxed. Likewise, it must be externally consistent; the factors used to apportion the income must bear a reasonable relation to the process by which the income was actually generated. *Id.* An apportionment formula is unacceptable if it discriminates against interstate or foreign commerce. *Id.*, at 170. A formula is unacceptable if the taxpayer can show "by 'clear and cogent evidence' that the income attributed to the State is in fact out of all appropriate proportion to the business transacted . . . in that State, or that it has 'led to a grossly distorted result.' " *Id.* To avoid taxation, a taxpayer must show that the income arose from a discrete business enterprise rather than from the unitary business operation and in the course of activities unrelated to its unitary business operation in the taxing state. *ASARCO, supra*, at 317, 319.

A unitary business is a "functionally integrated enterprise," *Container Corporation, supra*, at 179, wherein

"contributions to income [result] from functional integration, centralization of management, and economies of scale." *F. W. Woolworth Company v. Taxation and Revenue Department of New Mexico*, 458 U.S. 307, 364 (1982). The *Container Corporation* court stated:

> [F]or a state to tax income arising out of interstate activities, the out-of-state activities of the purported 'unitary business' must be related in some concrete way to the in-state activities. The functional meaning of this requirement is that there must be some sharing or exchange of value not capable of precise identification or measurement, beyond mere flow of funds arising out of passive investments or distinct business operations, which renders formula apportionment a reasonable method of taxation.

Container Corporation, supra, at 166.

WNG's interest income fell into two categories: Some of it came from funds loaned to WNG's corporate parent under demand notes, and some of it came from funds invested in short term "repo" transactions. In both cases, the money was excess working capital drawn from WNG's general accounts. When necessary, WNG withdrew the money from invested funds and used it for operations. WNG invested only money it anticipated not needing for 10 days, and it structured the investments to retain high liquidity. This money retained its character as WNG working capital.

The United States Supreme Court has recognized that capital transactions may serve an investment function or an operational function. *Container Corporation, supra,* at 180 n. 19. Where investments are "held 'to satisfy the needs for liquid capital in the [unitary] business,' "

Hellerstein, *State Taxation I: Corporate Income and Franchise Taxes* 528 (5th ed. 1983) (quoting *Sperry & Hutchinson Company v. Department of Revenue*, 270 Ore. 329, 331, 527 P.2d 729 (1974), "[interest] derived from temporary investment of working capital . . . constitutes income of the unitary business, and should, therefore, be apportionable by each of the states in which the business is conducted." *Id.*, at 551-52.

In determining a unitary business' scope, the United States Supreme Court emphasized control and funding. The Court looked to the "underlying economic realities." *ASARCO, supra*, at 319. WNG provided millions of dollars to its successive parents, each of which wholly-owned it. The parents used the money for intergroup funding and other purposes. The "underlying economic reality" was that WNG provided its parents with a captive money supply.

We conclude that this was the "exchange of value not capable of precise identification or measurement" which the *Container Corporation* court held to be the fundamental characteristic of the unitary business relationship. Likewise, we conclude that Williams and its subsidiaries and Northwest Energy and its subsidiaries constituted a "highly integrated business which benefit[ted] from an umbrella of centralized management and controlled interaction." *Exxon, supra*, at 224. Although the amount of the money advanced by WNG to its parents and the interest earned on it can be calculated, it is not possible to calculate the value to the parents of owning and controlling this copious cash source. The parents did not have to compete for the availability of this money; it was available on command. We conclude that the funds loaned by

WNG to its parents served an operational function of the unitary business and that WNG's interest income earned on those loans was business income, subject to taxation in Missouri as apportioned.

Unlike the notes discussed above, WNG's short-term investments did not benefit its corporate parents. WNG invested this money in "repos" or security repurchase transactions. The investments were limited in duration to facilitate WNG's using the money for operations if necessary. Nonetheless, the short term investments served an investment, rather than an operational, purpose. The interest income, therefore, was not unitary business income and was not apportionable. Under the Compact's allocation rules, none of this income was taxable in Missouri.

Finally, we also conclude that WPL's capital gains income from the Wood River stock sale was unitary business income. Wood River was a joint venture by which Koch and WPL were able to accomplish an operational purpose otherwise outside of their respective capabilities. Wood River and WPL were both common carriers; WPL's investment in Wood River can hardly be characterized as an investment in an unrelated, discrete business enterprise. Although WPL did not control Wood River, control is not the sole factor in determining a unitary business' scope.

Wood River served several operational, unitary business purposes: to deny an opportunity to competitors; to reduce the overhead and increase the profitability of WPL's existing pipelines in the shared rights-of-way; and to convert a $37 million expenditure into a profit. WPL's

involvement in Wood River, while not dominant, was hardly passive. WPL constructed, serviced and maintained two of the three Wood River pipeline segments. The Wood River line was available to WPL, and WPL used it for several months. We conclude that WPL's investment in Wood River served an operational purpose and that capital gains was business income subject to Missouri's taxation.

Summary

We conclude that the Director properly denied the Petitioners' refund claims because the Petitioners were not eligible, under the law, to file consolidated returns on the basis of combined reporting. We also conclude that the Director properly assessed WNG's interest income from advances to its corporate parents and WPL's capital gains income from the sale of its Wood River shares. However, the Petitioners have shown that the Director improperly assessed WNG's interest income from short term "repo" investments because that income was not business income and was not allocable to Missouri.

ENTERED this 12 day of December, 1989.

/s/ Paul M. Spinden
PAUL M. SPINDEN
Commissioner

MISSOURI DEPARTMENT OF REVENUE

WILLIAMS NATURAL GAS CO., (formerly Northwest Central Pipeline) PROTEST OF NOTICE OF DEFICIENCY CLAIM FOR REFUND YEAR: FYE 1985	CORPORATE INCOME TAX Final Decision
NORTHWEST CENTRAL PIPELINE, (formerly Cities Services Co.) (presently Williams Natural Gas Co) PROTEST OF NOTICES OF DEFICIENCY AND CLAIMS FOR REFUND YEAR: FYE 11/12/82, FYE 12/31/82, FYE 10/7/83, FYE 12/31/83, FYE 12/31/84	CORPORATE INCOME TAX Final Decision
WILLIAMS PIPELINE COMPANY, PROTEST OF NOTICE OF DEFICIENCY CLAIM FOR REFUND YEAR: FYE 1984	CORPORATE INCOME TAX Final Decision
THE WILLIAMS COMPANY & SUBS., CLAIMS FOR REFUND YEAR: FYE 1982, 1983, 1984	

FINDINGS OF FACT

This Final Decision is in response to protests to Notices of Deficiency and Claims for Refund made by

The Williams Company and/or by wholly owned subsidiaries of The Williams Company.

Northwest Central Pipeline, (formerly Cities Service Gas Co., presently Williams Natural Gas Co.) (hereinafter Northwest Central Pipeline) is a corporation domiciled in the state of Oklahoma for FYE 1982, 1983, 1984 and 1985 and doing business primarily as a wholesale supplier of natural gas in Wyoming, Texas, Kansas, Oklahoma, Missouri and Nebraska. Northwest Central Pipeline (formerly Cities Service Gas Company) was a subsidiary of Cities Service Company, until November 13, 1982, when it became a wholly owned subsidiary of Northwest Energy Company, a Utah corporation. On October 8, 1983, The Williams Companies purchased all the stock of Northwest Energy Company. Northwest Central Pipeline has subsequently been renamed *Williams Natural Gas Co.* and remains a wholly owned subsidiary of The Williams Company.

Williams Pipeline Company is a Delaware corporation headquartered in Tulsa, Oklahoma and doing business in Missouri for the years at issue. Williams Pipeline Company is a regulated common carrier pipeline and operates pipelines in approximately twelve states including Missouri and has terminals in Columbia and Springfield for the distribution of petroleum and petroleum products. Williams Pipeline Company is a wholly owned subsidiary of The Williams Company.

The Williams Company is a Nevada corporation headquartered in Tulsa, Oklahoma and engaged in the production, transmission, transportation, distribution and marketing of petroleum products for the years at issue.

The Williams Company is the parent company of the above wholly owned subsidiaries as well as other subsidiaries.

I. *Returns as Initially Filed:*

(a) Williams Pipeline Company filed a separate Missouri Corporate Income Tax Return for FYE 1984 on October 3, 1985.

(b) A separate Missouri Corporate Income Tax Return was filed for Northwest Central Pipeline for:

(1) FYE 1982 on October 17, 1983,

(2) FYE 1983 on October 2, 1984

(3) FYE 1984 on October 16, 1985 and

(4) FYE 1985 on October 14, 1986.

At the time of the FYE 1985 protest Northwest Central Pipeline Company was operating under the new and present name of Williams Natural Gas Co.

On their separate Missouri Corporate Income Tax Returns Northwest Central Pipeline Company (formerly Cities Service Gas and presently Williams Natural Gas) and Williams Pipeline Company each elected on Schedule MS to use multistate allocation and three-factor apportionment under the Multistate Tax Compact, Mo. Rev. Stat. § 32.200.

None of the corporations involved in any of these protests and Claims for Refund filed or were eligible to file a Missouri Consolidated return for the years at issue nor had any of them filed a Missouri consolidated return

for the year immediately preceding the years at issue. Nor did any of the above corporations petition the Director of Revenue, in writing, to be permitted to apportion income to Missouri under any alternate method pursuant to either Mo. Rev. Stat. § 32.200 art. IV Sec. 18 or Mo. Rev. Stat. § 143.431 and the supporting State Regulations, 12 CSR 10-2.050(5)(6)(7).

On those separate returns Northwest Central Pipeline Company for FYE 1982, FYE 1983, FYE 1984 and Northwest Central Pipeline (Williams Natural Gas Co) for FYE 1985 allocated as non-business income, income received from rent, royalties, interest and capital gains. For FYE 1984 Williams Pipeline allocated as nonbusiness income, income received from royalties and capital gain.

II. *Changes Upon Audit:*

Subsequent to an audit by an authorized agent of the Missouri Department of Revenue the tax of Northwest Central Pipeline Company, Williams Pipeline Company and Williams Natural Gas Company were recomputed, disallowing the allocation of the above income as non-business income and apportioning it as business income as follows:

CORP	YEAR	INTEREST	ROYALTY	RENT	GAIN
NWC	1982	$12,628,454	$ 45,520	$148,498	$17,200
NWC	1983	17,930,653	49,442	141,280	
NWC	1984	23,649,723	131,801	124,291	
NWC	1985 (WNG)	16,017,158	151,389	120,990	
WP	1984		18,672		15,024,470

Several other adjustments made by the auditor were agreed to by the taxpayer before the Notices of Deficiency were issued and are not the subject of this protest. One of those agreed adjustments was that the returns for Northwest Central Pipeline Company for FYE 1982 and 1983 be broken down into two returns for each year, since Northwest Central Pipeline was a member of two different consolidated federal returns for each of those years because of corporate mergers. Accordingly, the auditors recalculated the tax, issuing two Notices of Deficiency for each of those years.

III. *Final Notices of Deficiency:*

On October 14, 1986, Northwest Central Pipeline, in writing and for consideration, extended the Statute of Limitations for the mailing of the Notice of Deficiencies for FYE 1982 to November 30, 1986.

As a result of the audits, Final Notices of Deficiency for *Northwest Central Pipeline Company* (NWC) for, (1) FYE 11-12-82 and 12-31-82 issued on November 26, 1986, (2) FYE 10-7-83 and 12-31-83 and 12-31-84 issued on December 9, 1986, (3) FYE 1985 (Williams Natural Gas) issued on February 9, 1987; and (4) for *Williams Pipeline Company* (WPL) for FYE 1984 issued on November 25, 1986 were as follows:

CO.	FYE	TAX	INTER-EST	ADDI-TIONS	TOTAL
NWC	11/12/82	93,556.00	44,863.31	4,677.80	143,097.11
NWC	12/31/82	902.00	432.54	45.10	1,379.64
NWC	10/07/83	95,859.00	33,076.54	4,792.95	133,728.49
NWC	12/31/83	25,234.00	8,707.08	1,261.71	35,202.79
NWC	12/31/84	167,060.00	37,155.97	8,353.00	212,568.97
NWC	1985 (WNG)	78,078.00	9,239.12	3,903.90	91,221.02
WPL	1984	75,723.00	16,098.95	3,786.15	95,608.08

IV. *Protests and Claims for Refund:*

A single Protest to the Notices of Deficiency for Northwest Central Pipeline Company for FYE 1982, 1983, 1984 and for Williams Pipeline Company for FYE 1984 was received on January 26, 1987. An additional protest to the Notice of Deficiency for FYE 1985 for Northwest Central Pipeline Company (presently Williams Natural Gas) was filed on April 9, 1987 and a request for refund for overpayment for FYE 1985 of $46,070 was made in that protest.

In those protests it was argued: (1) that the taxpayers had the right to file amended returns using a "combined report/return" and that such a combined return was the only fair method to determine the tax from Missouri sources; and (2) in the alternative, that the rent, royalty and interest and capital gains income received by each taxpayer should be allocated as nonbusiness income because (a) the payors of the income were not part of the unitary business and (b) the assets used to produce that income were not part of the working capital of the taxpayer and thus not part of the unitary business.

An application for refund/credit and amended returns were also filed at that time for "Northwest Central Pipeline & Affiliated Companies" for FYE 11-12-82, FYE 12-31-82, FYE 10-7-83 and for "The Williams Company & Subsidiaries" for FYE 1982, 1983 and 1984 as follows:

Northwest Central Pipeline & Affiliated Companies – Amended Returns and Claims for Refund

FYE	AMOUNT
11/12/82	$106,217
12/31/82	211,127
10/07/83	923,002

The Williams Company & Subsidiaries – Amended Returns and Claims for Refund

FYE	AMOUNT
1982	$184,732
1983	592,313
1984	791,372

In a letter dated July 17, 1987 the claims for refunds/credits for "Northwest Central Pipeline & Affiliated Companies" and for "The Williams Company & Subsidiaries" were denied. The denial of the claim for refund for "The Williams Companies & Subsidiaries" for FYE 1982, FYE 1983 and FYE 1984 was protested on September 18, 1987. No protest was received regarding the denial of the claims for refunds/credits for "Northwest Central Pipeline & Affiliated Companies" for FYE 11-12-82, FYE 12-31-82 and FYE 10-7-83.

BASIS FOR DECISION

I. *Business/Nonbusiness Income Issue:*

Taxpayers elected to file using three-factor apportionment under Mo. Rev. Stat. § 32.200 art. III, therefore, we must look *first* to Missouri statutory law and supporting regulations to determine what constitutes business and nonbusiness income. The Multistate Tax Compact, Mo. Rev. Stat. § 32.200, art. IV Sec. 1(1) defines "business income" as "income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business." Mo. Rev. Stat. § 32.200, art. IV Sec. 1(5) defines "nonbusiness income" as "all income other than business income"

Missouri has also adopted the Multistate Tax Commission Regulations which further interprets the Multistate Tax Compact. 12 CSR 10-2.075(4) accordingly states:

> Business and Nonbusiness Income Defined: Article IV.1 defines "business income" as income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations. In essence, all income which arises from the conduct of trade or business operations of a taxpayer is business income. For purposes of administration of Article IV, the income of the taxpayer is business income unless clearly classifiable as nonbusiness income. Nonbusiness income means all income

> other than business income. The classification of income by the labels occasionally used, such as manufacturing income, compensation for services, sales income, interest, dividends, rents, royalties, gains, operating income, nonoperating income, etc., is of no aid in determining whether income is business or non-business income. Income of any type or class and from any source is business income if it arises from transactions and activity occurring in the regular course of a trade or business.

(a) *Interest Income* –

12 CSR 10-2.075(5)(c) further sets out rules for determining whether or not income from interest constitutes business income:

"Interest income is business income where the intangible with respect to which the interest was received arises out of or was created in the regular course of the taxpayer's trade or business operations or *where the purpose for acquiring and holding the intangible is related to or incidental to such trade or business operations.*"

The purpose for acquiring and holding the intangibles at issue in this case is related to or incidental to Northwest Central Pipeline's trade or business operations. The interest income was from investment of funds *"not needed in the next ten days."* These funds were transferred to another affiliate which operated an investment fund used for investments and intercompany loans. Any amounts needed in the business after the ten days were recycled back into the business and used to pay for the operating costs of the business. Northwest Central was permitted to borrow from this same account. The funds invested were not part of the nonworking capital but

rather were part of the business working capital. Furthermore, the largest source of funds invested with the corporate finance office came from the collection of accounts receivables, of which approximately 40% came from Missouri sales. Therefore, the interest from those funds are business income to be apportioned. In addition, as shown on each taxpayer's "separate federal returns" submitted with their original separate Missouri returns, each taxpayer for each of those years at issue had incurred a large amount of debt in order to finance, at least indirectly, the claimed nonbusiness investments. The interest from this debt was deducted as a business expense. This incurred debt is indication that the investments were not from nonworking capital and "excess funds", but rather were income from the short term investment of working capital used in the unitary business and therefore, properly classified as business income.

Furthermore, even if the interest income were nonbusiness income, [pursuant to Mo. Rev. Stat. § 32.200, art. IV Sec. 18] the Director of Revenue is justified in upholding the assessments in order to offset the tax advantage the taxpayers received from deducting the interest they paid on loans that indirectly financed the investments in question.

(b) *Royalty Income* –

The royalty income to Northwest Central Pipeline for FYE 1982, 1983, 1984 and for Williams Natural Gas (Northwest Central Pipeline) for FYE 1985 was from (1) oil wells drilled on company property not in Missouri

and (2) the "sale" of "condensate" extracted from the pipeline at a Kansas Compressor station.

The taxpayers state that the loyalty income received is not business income because the payor was not part of the unitary business. However, Northwest Central Pipeline's (presently Williams Natural Gas Co.) principal business was purchasing, transporting and selling petroleum products in interstate commerce. The "sale" of petroleum extracted from the pipeline and the oil wells drilled are petroleum related activities that were conducted on taxpayers property. The property which produced the royalties was included by the taxpayer in their property factor for the years at issue. These activities conducted on taxpayers property are thus "related to" and incidental to taxpayers trade or business. Therefore, the royalties were business income to be apportioned.

(c) *Rental Income* –

Similarly, 12 CSR 10-2.075(5)(a) further outlines whether rental income is business or nonbusiness income. It states:

> Rents From Real and Tangible Personal Property: Rental income from real and tangible property is business income if the property with respect to which the rental income was received is used in the taxpayer's trade or business or incidental thereto and therefore is includable in the property factor under sections (21) through (24) of this rule.

The rental income was principally from residences acquired along the pipeline right-of-way. In many instances, the houses were rented to company personnel.

Only the rental property in Missouri, was allocated to Missouri. However, *all the rental property both in and out of the state of Missouri was included in the property factor of the taxpayer for the years at issue.* Since the rental property was on the pipeline right-of-way and included in the property factor of taxpayers business and used by the business to increase access to employees, the rental income is business income to be apportioned.

(d) *Capital Gains Income-Williams Pipeline Company FYE 1984* –

For FYE 1984 Williams Pipeline Company allocated capital gains income received from the sale of stock in Wood River as non-business income. Williams Pipeline Company was and is a common carrier pipeline for the distribution of petroleum products in several states. Wood River was formed by Williams Pipeline Company and Koch Industries, Inc. for the purpose of transporting petroleum by pipeline from Illinois to Minnesota.

The business of Wood River was nearly identical to the business of Williams Pipeline Company which is the transportation by pipeline of petroleum. The stock obtained by Williams Pipeline Company in Wood River was exchanged for pipeline and right-of-ways previously owned and used by Williams Pipeline Company. In essence, the substance of the transaction was that instead of Williams Pipeline Company owning the pipeline and right-of-way and performing the transportation of petroleum directly, Williams Pipeline Company owned preferred stock in Wood River which then performed the petroleum transportation function. Instead of receiving

business income directly through the direct transportation of petroleum, taxpayer was receiving business income indirectly from dividends and capital gains received from the new corporation Williams Pipeline Company had set up with Koch, Inc. An agreement was also entered into between Koch and Williams Pipeline Company regarding the operation of Wood River for their mutual benefit. No doubt the oil which Williams Pipeline Company transported continued on its journey through the Wood River Pipeline. Certainly, this represents a flow of value between the two companies.

Furthermore, although Williams Pipeline Company claims that the property assets it exchanged for the stock in Wood River were removed from the property factor, Williams Pipeline Company doesn't indicate when this was done nor does it offer any facts to substantiate this.

In addition, Williams Pipeline Company did not report any capital gain at the time it exchanged the pipeline and right-of-way for the preferred stock. It delayed the recognition of that gain. Therefore, at the time of the sale of the preferred stock, the capital gain ultimately resulting from the exchange of these business assets should be classified as business income to be apportioned, particularly when Wood River is in the exact same business as Williams Pipeline Company: *the transportation of petroleum products by pipeline*. Wood River was in fact part of the unitary business of Williams Pipeline Company and the capital gains received from the sale of the preferred stock in Wood River is business income to be apportioned.

Although the taxpayer did report the dividends received for earlier years as nonbusiness income and the department did not, for various reasons, take action to challenge or change that designation, such previous action or inaction by the Department does not bind it for the future.

(e) *Capital Gain Income to Northwest Central Pipeline Company (formerly Cities Service Gas. Co.) for FYE 1982* –

Northwest Central Pipeline has claimed capital gain of $17,622 from the sale of land in 1982 as nonbusiness income. Although taxpayer states that the land was not located in Missouri, that fact is not dispositive of whether the gain from the sale of the land is business income as indicated in 12 CSR 10-2.075(4) above. 12 CSR 10-2.075(5)(b) gives criteria for determining whether the Gains or Losses From Sales of Assets is business or nonbusiness income as follows:

> Gains or Losses From Sales of Assets: Gain or loss from the sale, exchange or other disposition of real or tangible or intangible personal property constitutes business income if the property while owned by the taxpayer was used in the taxpayer's trade or business. However, if such property was utilized for the production of nonbusiness income or otherwise was removed from the property factor before its sale, exchange or other disposition, the gain or loss will constitute nonbusiness income."

Taxpayer has not indicated (1) what land was sold, (2) whether the land was included in taxpayer's property factor or (3) what the land was used for. Therefore, the

gain from the land was not shown to be nonbusiness income and must be classified as business income and apportioned.

(f) *Case Law Does Not Support Taxpayers Claim of Nonbusiness Income* –

Taxpayers in large part rely on *Asarco Inc. v. Idaho State Tax Commission*, 102 S.Ct. 3103 (1982) to support their claim that the interest, royalty, rent and capital gains income in question is nonbusiness income to be allocated and not apportioned. The court in ASARCO held that the State of Idaho could not tax interest and capital gain income to the parent from it's foreign subsidiaries where the subsidiaries were not part of the unitary business. In that case the court held "that the business activities of the dividend payor had nothing to do with the activities of the recipient in the taxing state and the income at issue was not business income".

Taxpayer however misplaces its' reliance on that case. The Court in *ASARCO* states that the principals [sic] followed in *ASARCO* are more thoroughly set out in *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 100 S.Ct. 1223 (1980). *ASARCO, supra*, pg. 3116 n. 24. The two tests as articulated in *Mobil* were (1) whether the payor was part of the recipient taxpayer's unitary business *or* (2) whether the asset used to generate the income was used in taxpayer's trade or business even though payor was not part of the unitary business.

While the main focus of *ASARCO* was test (1) whether the payor was part of the unitary business, the court in *ASARCO* does not drop the second test. Rather,

the court noted that "ASARCO was never required to utilize its stock as security for borrowing working capital, acquiring stock or to support any bond issues" and was found to have had sufficient cash flow from mining to provide operating capital for all mining operations without reliance upon cash flow from . . . income from intangible." pg. 3114 n. 21. Therefore, the income in question was a mere passive investment and was not used as an asset in taxpayer's trade or business beyond merely "adding to the riches" of the corporation.

Unlike *ASARCO* where (1) the payor was not part of the unitary business, and (2) the assets used to generate the income were not used in taxpayer's trade or business (as working capital, security for borrowing, acquiring stock or for supporting bond issues) the claimed nonbusiness income of present taxpayer was derived from assets which were used in the trade or business and thus are part of the unitary business under the second test and is business income even though the payor is not part of the unitary business. The investment income was in reality part of the working capital and not excess funds. The royalty and rental income were from activities on taxpayer's land. Land that was included in taxpayers' property factor. The capital gain was from the stock acquired in exchange for taxpayer's pipeline and right-of-way assets. Instead of receiving business income directly through the direct transportation of petroleum, taxpayer was receiving business income indirectly from dividends and capital gains from the new corporation set up to transport, by pipeline, petroleum products. Therefore, under the second test, the income was used in taxpayers

trade or business and is unitary business income to be apportioned.

Likewise, taxpayers's [sic] reliance on *James v. International Telephone and Telegraph Corporation*, 654 S.W. 2d 865 (Mo. banc 1983) is also misplaced. In that case the court held that long-term capital gains income of nonresident corporation from divestiture of four subsidiaries pursuant to a consent decree did not constitute business income for purpose of income allocation and apportionment pursuant to multistate tax compact. In that case *ITT*, as a result of antitrust action and a consent degree, was "forced" to sell its stock in Avis Company, Hamilton Life Insurance Company and Canteen Corporation. Williams Pipeline Company was not involved in such antitrust action. Furthermore, the Avis Corporation engaged in automobile renting and leasing, Canteen Corporation engaged in food vending and distribution and Hamilton Life Insurance Company engaged in the sale of insurance. *ITT* was engaged in the electronics and communication business. *James v. ITT, supra*, pg. 869.

The "forced" sale was a key factor in the Court's finding in *ITT* that the sale was not in the regular course of taxpayer's business. Furthermore, unlike the payors in *ITT* who were in totally different lines of business than *ITT*, Wood River is in the same type of business that Williams Pipeline Company is engaged in, namely the business of transportation of gas by pipeline.

Most importantly, subsequent to *ASARCO* the United States Supreme Court reviewed the three factor apportionment formula and the "unitary business" principle in *Container Corporation of America vs. Franchise Tax Board*,

103 S.Ct. 2933, 1983. The United States Supreme Court stated there that the essential feature of a unitary business was *a flow of value beyond a mere passive investment.* "That the out-of-State activities of the purported "unitary business" be related in some concrete way to the in-State activities. The functional meaning of this requirement is that there be *some sharing or exchange of value not capable of precise identification or measurement – beyond the mere flow of funds arising out of a passive investment or a distinct business operation,* which renders formula apportionment a reasonable method of taxation." *Container, supra,* pg. 2940.

The court in *Container* further stated:

> There are variations on the theme of a unitary business and any number of them are logically consistent with the underlying principles motivating the approach.
>
> . . . this Court will, if reasonably possible, defer to the judgment of state courts in deciding whether a particular set of activities constitutes a "unitary business." *Container,* pgs. 2941, 2945

Under both United States Constitutional Standards and Missouri case law and statutes, the income in question is part of the unitary business because there is a flow of value beyond the mere flow of funds arising out of a passive investment or a distinct business opertion [sic] as indicated in (a) through (e) above and thus the income at issue is properly included as business income.

II. *Double Taxation*

Taxpayers claim of double taxation likewise is unfounded. The test is whether the formula uniformly

applied would result in double taxation. *Container Corp., supra,* pg. 2950. That test is met. Although, Oklahoma chooses to tax all the income of domicilary corporations, that is not double taxation since the tax on a resident's income is based on a different incident of tax than the tax on a non-resident's income.

III. *Apportionment Factor Relief*

Neither Northwest Central Pipeline nor Williams Pipeline Company, are entitled to include the property, payroll and sales of the payor in their apportionment factors. Mo. Rev. Stat. § 32.200 is directed to apportioning the income to the taxpayer and not the income of the payor. Mo. Rev. Stat. § 32.200 requires that the property, payroll and sales of the taxpayer be included in the apportionment factors. The payor of income to the taxpayer is not the taxpayer. Just as Mo. Rev. Stat. § 32.200 requires that only the income to the taxpayer be apportioned, (the rent, royalty, investment and gain income is income to the taxpayer and an expense or cost to the payor), similarly, Mo. Rev. Stat. § 32.200 allows only the inclusion of property, payroll and sales of the taxpayer in the apportionment factor and not the payroll, property and sales of the payor. Property, payroll, and sales are a measure of activity. They are *not* used to measure the activity of the person who pays the income. They are used to measure the activity of the person who receives the income.

For example, if (1) the payor pays taxpayer one million dollars in interest for money borrowed from taxpayer

or (2) if payor pays taxpayer ten million dollars in royalties for the privilege of using a product which taxpayer has developed or (3) if payor pays the taxpayer twenty million dollars in dividends, the state is taxing the income to the taxpayer not the payments made by the payor. Therefore, the relevant property, payroll and sales used in apportioning the income to the taxpayer is the property, payroll and sales of the taxpayer and not the property payroll and sales of the payor. If taxpayer does business with hundreds of business [sic] from which it receives business income of all types, including sales, should taxpayer be allowed to include the property, payroll and sales of all those hundreds of business's in taxpayers apportionment formula? Of course, not.

While interest of gain income may be different *in form* from sales income, form is not determinative for purposes of taxation. The taxpayer is using his assets to produce income. We should no more include the property, payroll and sales of the payor of interest or royalty income in the taxpayer's apportionment fraction than include the property, payroll and sales of the purchases of goods from taxpayer. Accordingly, in *Comptroller of the Treasury v. NCR Corp.*, 71 Md. App. 116, 524 A2d 93, 105 (Ct. Spec. App. 1987) the royalty and dividend income was taxable, not as income of the foreign subsidiaries, but as income of the domestic parent earned in the ordinary course of its unitary business. Therefore, it was held that the parent's taxable income did not reflect the actual income earned by any of its foreign subsidiaries, the apportionment formula mirrors that approach and the property, payroll and sales of the payor is not included in the apportionment formula.

IV. *Amended Returns Combined Reporting Issue:*

Northwest Central Pipeline & Affiliated Companies submitted amended returns for FYE 11-12-82, FYE 12-31-82, FYE 10-7-83 and The Williams Company & Subsidiaries submitted amended returns for FYE 1982, 1983 and 1984, filing on a combined return/report basis and Claiming Refunds for those years.

(a) Northwest Central Pipeline & Affiliated Companies amended returns were received January 22, 1987. Under Mo. Rev. Stat. § 143.801 a claim for refund "must be filed within 3 years from the time the return was filed or two years from the time the tax was paid, whichever of such periods expires the later." The original return for FYE 1982 was filed on 10-17-83. The tax computed by taxpayer as due was paid at that time. The amended returns and claim for refund for FYE 11/12/82 and FYE 12-31-82 were filed on January 26, 1987 which was beyond the Statute of Limitations for filing an amended return. Therefore, the claim for refund for FYE 1982 was properly denied.

(b) Furthermore, the Claim for Refund for Northwest Central Pipelines & Affiliated Companies for FYE 11/12/82, 12/31/82 and 10/7/83 was denied on July 17, 1987. No protest to the denial of the Claim for Refund for Northwest Central Pipeline and Affiliated Companies was received.

Mo. Rev. Stat. § 143.841 requires that:

> 1. Within sixty days after denial of the claim, the taxpayer may file with the director of revenue a written protest against such denial setting forth the grounds on which the protest is based.

> If a protest is filed, the director of revenue shall reconsider the denial.
>
> Mo. Rev. Stat. § 143.831 states that:
>
> The action denying a claim for refund is final upon the expiration of sixty days from the date when he mails notice of his action to the taxpayer, except only for such amounts as to which the taxpayer has filed a protest with the director of revenue.

Because no protest was filed with the Director of Revenue against the denial of the refund claim for Northwest Central Pipeline & Affiliated Companies and it is well beyond the sixty days, the action denying the claim is final and cannot be reconsidered.

If a protest had been filed, the decision of the Director of Revenue upon reconsideration would be to deny the claims on the same basis as indicated for the Williams Company and Subsidiaries as indicated below.

(c) In regard to the other amended returns and claims for refunds that were filed within the statute of limitations and protested, since the taxpayers involved in the claims for refund had originally elected on Schedule MS to file a separate return under the three factors apportionment formula, it is too late for the taxpayers to file amended returns and change their method of filing. The Missouri Supreme Court in *Bartlett & Company Grain v. Director of Revenue*, 649 S.W.2d 220 (Mo. 1983) held that taxpayer could not switch from three-factor to single factor or vice versa once the election was made and the return filed. An even greater change from a separate return to a "combine return" would likewise be prohibited.

Furthermore, taxpayers involved in these combined returns did not petition the Director of Revenue, in writing, to be permitted to apportion income to Missouri according to "any other Method" under either Mo. Rev. Stat. § 32.200 art. IV Sec. 18 or Mo. Rev. Stat. § 143.461 or under 12 CSR 10-2.050(5)(6)(7) which further delineates when the how petitioning is to be done. The time to petition for an alternative method was before the return was filed. Amended returns are not allowed for this purpose.

(d) *Missouri statutory law does not allow for the use of such a combined return/report, nor does the Multistate Tax Compact, adopted in Mo. Rev. Stat. § 32.200, nor does state or U.S. case law require it.*

Under Missouri statutory law, corporations which are part of a federal consolidated return but are not eligible to file a Missouri consolidated return do not have a right to file a combined return/report which uses the federal consolidated taxable income of a group of corporations and not the separate federal income of the corporation as if that individual corporation had filed a separate federal return.

Mo. Rev. Stat. § 143.431.3(4) requires that:

> (4) For each taxable year an affiliated group of corporations filing a federal consolidated income tax return does not file a Missouri consolidated income tax return, for purposes of computing the Missouri income tax, *the federal taxable income of each member of the affiliated group shall be determined as if a separate federal income tax return had been filed by each such member.* (Emphasis Added)

The language of this statute is mandatory. The mandatory language demonstrates the legislative intent to determine the federal taxable income of a corporation, not eligible to file a Missouri consolidated return, in only one way: "as if a separate federal income tax return had been filed by each such member." Furthermore, the Missouri Supreme Court in *Mid-American Television v. State Tax Comm'n*, 652 S.W.2d 674, 680 (Mo. banc 1983) explicitly stated that when a corporation does not derive 50 percent or more of its income from sources within the state it is (1) not eligible to file a Missouri consolidated return, *and* (2) *must under Mo. Rev. Stat. § 143.431.3(4) "determine it's federal taxable income as if it had filed a separate federal return. The [tax] basis for A's Missouri return thus would be what A's federal return would have been if A had filed as a separate entity."*

The legislative purpose behind Mo. Rev. Stat. § 143.431.3(4), as articulated in *Mid-America Television, supra*, pg. 680, was to permit a group of corporations, separately incorporated, to be treated as a single entity for income tax purposes but under very restricted circumstances. Certainly, the legislature did not in the adoption of the Multistate Tax Compact give blanket authorization to all corporations which are part of a unitary business to have their separate corporate entities disregarded by allowing a "combined report/return using the federal consolidated income as the tax base.

Furthermore, the Missouri Legislature has provided for only one situation where the Director of Revenue is prohibited from requiring a separate return from each individual corporation taxable in Missouri. That situation is when the corporation is part of a federal consolidated

return *and* is eligible for and files a Missouri Consolidated Return. Mo. Rev. Stat. § 143.431.3(3). The taxpayers in this case were not eligible for and did not file a Missouri Consolidated Return.

The adoption of the Multistate Tax Compact in Mo. Rev. Stat. § 32.200 does not give taxpayer the right to file a "combine report/return", using as the tax base the federal consolidated income. The tax base is not established by Mo. Rev. Stat. § 32.200, rather the tax base is established by Mo. Rev. Stat. 143.431.3(4). *The adoption of the Multistate Tax Compact merely provides a method of apportioning and allocating the income that the corporation is required under Mo. Rev. Stat. § 143.431.3(4) to use as it's tax base.* Furthermore, in *Goldberg v. State Tax Comm'n*, 639 S.W. 2d 796, 799 (Mo. 1982) the Missouri Supreme Court has held that the Multistate Tax Compact does not take precedence over Missouri statutory law.

Furthermore, while some states have found authority under the Multistate Tax Compact for the state to require such a combine report/return (combining the income of two or more corporations which are unitary or part of a single trade or business and using the federal consolidated income as the tax base) *none have held that the Multistate Tax Compact in and of itself requires the state to accept combined returns nor does it give taxpayer the right to file such a combined report/reiurn. Caterpillar Tractor Co. v. Lenckos*, 417 N.E.2d 1343 (Ill. 1981), *Coleco Industries, Inc. v. State Tax Comm'n*, 461 N.W.2d 462 (A.D. 1983), *Polaroid Corporation v. Commissioner of Revenue*, 472 N.W.2d 259 (Mass. 1984), *Josling Dry Goods v. Dolan*, 615 P.2d 16 (Colo. en banc 1980), *P.M.D. Investment Co. v. State*, 345 N.W.2d 815 (Neb. 1984), *Pioneer Container Corp. v. Beshears*, 684

P.2d 396 (Kan. 1984), *Coca Cola Co. v. Department of Revenue*, 533 P.2d 788 (Or. 1975). In fact, in both *Westinghouse Electric Corp. v. Commissioner of Revenue*, 393 N.W.2d 530 (Minn. 1986) and in *Chesapeake Industries v. Comptroller*, 475 A.2d 1224 (Md. App. 1984), it was held that the state was *not* required to accept a combine [sic] report/return and the taxpayer did not have a right to file such a return.

Furthermore, the United States Supreme Court in *Container Corp. of America v. Franchise Tax Board*, 103 S.Ct. 2933, 2991 (1983), has held that apportionment of the total income of all corporations which are part of the unitary business is *constitutional but not constitutionally required.*

Furthermore, while the Multistate Tax Commission Regulation art. IV Sec. 2(b)(2) adopted by Missouri in Mo. Rev. Stat. § 32.200 states that nothing in art. IV or in its regulations shall preclude the use of a combined report, nothing in art. IV or in its regulations *requires* the state to accept combined reporting. Furthermore, the substantive statutory law of Missouri precludes such a combined report because Mo. Rev. Stat. § 143.431.3(4) requires the use of the separate federal taxable income of the corporation as if it had filed a separate return as the tax base when a corporation files a federal consolidated return but is not eligible to file a Missouri consolidated return.

The unitary business concept can only be applied consistent with Missouri substantive statutory law and constitutional requirements. Mo. Rev. Stat. § 32.200 does not change or supersede the required tax based to be used as established in Mo. Rev. Stat. § 143.451. Mo. Rev. Stat. § 32.200 provisions for the allocation and apportionment must be applied to the *tax base of the taxpayer as*

established in Mo. Rev. Stat. § 143.451. Therefore, the denial of the claims for refund are affirmed.

DECISION

It is the Final Decision of the Director of Revenue upon reconsideration that the Final Notices of State Income Tax Deficiency issued against Northwest Central Pipeline (NWC) (formerly Cities Service Gas Company, presently Williams Natural Gas Co. (NWG)) and the Williams Pipeline Company (WPL) are correct and remain outstanding and that the claims for refunds by Northwest Central Pipeline & Affiliated Companies and for the Williams Company & Subsidiaries and Williams Natural Gas for FYE 1985 are denied. Therefore, the amounts of deficiency owed as of February 26, 1988 are as follows:

Co.	FYE	Tax	Interest	Additions	Total
NWC	11/12/82	93,556.00	58,453.79	4,677.80	156,687.59
NWC	12/31/82	902.00	549.05	45.10	1,496.15
NWC	10/07/83	95,859.00	48,102.05	4,792.95	148,754.00
NWC	12/31/83	25,234.00	11,958.39	1,261.71	38,454.10
NWC	12/31/84	167,060.00	58,704.88	8,353.00	234,117.88
NWC	1985 (WNG)	78,078.00	17,505.09	3,903.90	99,486.99
WPL	1984	75,723.00	26,609.06	3,786.15	106,118.21

If you were adversely affected by this decision, you may appeal to the Administrative Hearing Commission. To appeal, you must file a petition with the Administrative Hearing Commission within thirty days after the date this decision was mailed or the date it was delivered, whichever date was earlier. If any such petition is sent by registered mail, it will be deemed filed on the date it is mailed; if it is sent by any method other than registered

mail, it will be deemed filed on the date it is received by the Commission.

/s/ Barbara Hoppe Eldred
Barbara Hoppe Eldred
Assistant General Counsel

DATE 2/24/88

§ 1501. Privilege to file consolidated returns

An affiliated group of corporations shall, subject to the provisions of this chapter, have the privilege of making a consolidated return with respect to the income tax imposed by chapter 1 for the taxable year in lieu of separate returns. The making of a consolidated return shall be upon the condition that all corporations which at any time during the taxable year have been members of the affiliated group consent to all the consolidated return regulations prescribed under section 1502 prior to the last day prescribed by law for the filing of such return. The making of a consolidated return shall be considered as such consent. In the case of a corporation which is a member of the affiliated group for a fractional part of the year, the consolidated return shall include the income of such corporation for such part of the year as it is a member of the affiliated group.

Aug. 16, 1954, c. 736, 68A Stat. 367.

§ 1504. Definitions

(a) Definition of "affiliated group". – As used in this chapter, the term "affiliated group" means one or more chains of includible corporations connected through stock ownership with a common parent corporation which is an includible corporation if –

> (1) Stock possessing at least 80 percent of the voting power of all classes of stock and at least 80 percent of each class of the nonvoting stock of each of the includible corporations (except the common parent corporation) is owned directly by one or more of the other includible corporations; and
>
> (2) The common parent corporation owns directly stock possessing at least 80 percent of the voting power of all classes of stock and at least 80 percent of each class of the nonvoting stock of at least one of the other includible corporations.

As used in this subsection, the term "stock" does not include nonvoting stock which is limited and preferred as to dividends, employer securities (within the meaning of section 409A(*l*)) while such securities are held under a tax credit employee stock ownership plan, or qualifying employer securities (within the meaning of section 4975(e) (8)) while such securities are held under a[1] employee stock ownership plan which meets the requirements of section 4975(e) (7).

(b) Definition of "includible corporation". – As used in this chapter, the term "includible corporation" means any corporation except –

> (1) Corporations exempt from taxation under section 501.

(2) Insurance companies subject to taxation under section 802 or 821.

(3) Foreign corporations.

(4) Corporations with respect to which an election under section 936 (relating to possession tax credit) is in effect for the taxable year.

[(5) Repealed. Pub.L. 94-455, Title X, § 1053(d) (2), Oct. 4, 1976, 90 Stat. 1649]

(6) Regulated investment companies and real estate investment trusts subject to tax under subchapter M of chapter 1.

(7) A DISC or former DISC (as defined in section 992(a)).

(c) **Includible insurance companies.** – Notwithstanding the provisions of paragraph (2) of subsection (b) –

(1) Two or more domestic insurance companies each of which is subject to tax under section 802 shall be treated as includible corporations for purposes of applying subsection (a) to such insurance companies alone.

(2)(A) If an affiliated group ([2]determined without regard to subsection (b)(2) includes one or more domestic insurance companies taxed under section 802 or 821, the common parent of such group may elect (pursuant to regulations prescribed by the Secretary) to treat all such companies as includible corporations for purposes of applying subsection (a) except that no such company shall be so treated until it has been a member of the affiliated group for the 5 taxable years immediately preceding the taxable year for which the consolidated return is filed.

(B) If an election under this paragraph is in effect for a taxable year –

(i) section 243(b)(6) and the exception provided under section 243(b)(5) with respect to subsections (b)(2) and (c) of this section,

(ii) section 542(b)(5), and

(iii) subsection (a)(4) and (b)(2)(D) of section 1563, and the reference to section 1563(b)(2)(D) contained in section 1563(b)(3)(C),

shall not be effective for such taxable year.

(d) Subsidiary formed to comply with foreign law. – In the case of a domestic corporation owning or controlling, directly or indirectly, 100 percent of the capital stock (exclusive of directors' qualifying shares) of a corporation organized under the laws of a contiguous foreign country and maintained solely for the purpose of complying with the laws of such country as to title and operation of property, such foreign corporation may, at the option of the domestic corporation, be treated for the purpose of this subtitle as a domestic corporation.

(e) Includible tax-exempt organizations. – Despite the provisions of paragraph (1) of subsection (b), two or more organizations exempt from taxation under section 501, one or more of which is described in section 501(c)(2) and the others of which derive income from such 501(c)(2) organizations, shall be considered as includible corporations for the purpose of the application of subsection (a) to such organizations alone.

Aug. 16, 1954, c. 736, 68A Stat. 369; Mar. 13, 1956, c. 83, § 5(8), 70 Stat. 49; Sept. 2, 1958, Pub.L. 85-866, § 64(d)(3), 72 Stat. 1657; June 25, 1959, Pub.L. 86-69, § 3(f)(1), 73 Stat. 140; Sept. 23, 1959, Pub.L. 86-376, § 2(c), 73 Stat. 699; Sept. 14, 1960, Pub.L. 86-779, § 10(j), 74 Stat. 1009; Apr. 14, 1966,

Pub.L. 89-389, § 4(b)(3), 80 Stat. 116; Dec. 30, 1969, Pub.L. 91-172, Title I, § 121(a)(4), 83 Stat. 537; Dec. 10, 1971, Pub.L. 92-178, Title V, § 502(e), 85 Stat. 550; Oct. 4, 1976, Pub.L. 94-455, Title VIII, § 803(b)(3), Title X, §§ 1051(g), 1060(d)(2), Title XV, § 1507(a), 90 Stat. 1584, 1646, 1649, 1739; Nov. 6, 1978, Pub.L. 95-600, Title I, § 141(f)(4), 92 Stat. 2795; Apr. 1, 1980, Pub.L. 96-222, Title I, § 101(a)(7)(L)(i)(VIII), (iv)(II), 94 Stat. 199, 200.

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[1] So in original. Probably should be "an".

[2] So in original. No closing parenthesis.

32.200. Multistate tax compact

The "Multistate Tax Compact" is hereby enacted into law and entered into with all jurisdictions legally joining therein, in the form substantially as follows:

MULTISTATE TAX COMPACT

Article I

The purposes of this compact are to:

1. Facilitate proper determination of state and local tax liability of multistate taxpayers, including the equitable apportionment of tax bases and settlement of apportionment disputes.

2. Promote uniformity or compatibility in significant components of tax systems.

3. Facilitate taxpayer convenience and compliance in the filing of tax returns and in other phases of tax administration.

4. Avoid duplicative taxation.

Article II

As used in this compact:

1. **"State"** means a state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, or any territory or possession of the United States.

2. **"Subdivision"** means any government unit or special district of a state.

3. **"Taxpayer"** means any corporation, partnership, firm, association, governmental unit or agency or person acting as a business entity in more than one state.

4. **"Income tax"** means a tax imposed on or measured by net income including any tax imposed on or measured by an amount arrived at by deducting expenses from gross income, one or more forms of which expenses are not specifically and directly related to particular transactions.

5. **"Capital stock tax"** means a tax measured in any way by the capital of a corporation considered in its entirety.

6. **"Gross receipts tax"** means a tax, other than a sales tax, which is imposed on or measured by the gross volume of business, in terms of gross receipts or in other terms, and in the determination of which no deduction is allowed which would constitute the tax an income tax.

7. **"Sales tax"** means a tax imposed with respect to the transfer for a consideration of ownership, possession or custody of tangible personal property or the rendering of services measured by the price of the tangible personal property transferred or services rendered and which is required by state or local law to be separately stated from the sales price by the seller, or which is customarily separately stated from the sales price, but does not include a tax imposed exclusively on the sale of a specifically identified commodity or article or class of commodities or articles.

8. **"Use tax"** means a nonrecurring tax, other than a sales tax, which

(a) is imposed on or with respect to the exercise or enjoyment of any right or power over tangible personal property incident to the ownership, possession or custody of that property or the leasing of that property from another including any consumption, keeping, retention, or other use of tangible personal property; and

(b) is complementary to a sales tax.

9. **"Tax"** means an income tax, capital stock tax, gross receipts tax, sales tax, use tax, and any other tax which has a multistate impact, except that the provisions of articles III, IV and V of this compact shall apply only to the taxes specifically designated therein and the provisions of article IX of this compact shall apply only in respect to determinations pursuant to article IV.

Article III

1. Any taxpayer subject to an income tax whose income is subject to apportionment and allocation for tax purposes pursuant to the laws of a party state or pursuant to the laws of subdivisions in two or more party states may elect to apportion and allocate his income in the manner provided by the laws of such state or by the laws of such states and subdivisions without reference to this compact, or may elect to apportion and allocate in accordance with article IV. This election for any tax year may be made in all party states or subdivisions thereof or in any one or more of the party states or subdivisions thereof without reference to the election made in the others. For the purposes of this paragraph, taxes imposed by subdivisions shall be considered separately from state taxes and the apportionment and allocation also may be

applied to the entire tax base. In no instance wherein article IV is employed for all subdivisions of a state may the sum of all apportionments and allocations to subdivisions within a state be greater than the apportionment and allocation that would be assignable to that state if the apportionment or allocation were being made with respect to a state income tax.

2. Each party state or any subdivision thereof which imposes an income tax shall provide by law that any taxpayer required to file a return, whose only activities within the taxing jurisdiction consists of sales and do not include owning or renting real estate or tangible personal property, and whose dollar volume of gross sales made during the tax year within the state or subdivision, as the case may be, is not in excess of $100,000 may elect to report and pay any tax due on the basis of a percentage of such volume, and shall adopt rates which shall produce a tax which reasonably approximates the tax otherwise due. The multistate tax commission, not more than once in five years, may adjust the $100,000 figure in order to reflect such changes as may occur in the real value of the dollar, and such adjusted figure, upon adoption by the commission, shall replace the $100,000 figure specifically provided herein. Each party state and subdivision thereof may make the same election available to taxpayers additional to those specified in this paragraph.

3. Nothing in this article relates to the reporting or payment of any tax other than an income tax.

Article IV

1. As used in this article, unless the context otherwise requires:

(1) **"Business income"** means income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.

(2) **"Commercial domicile"** means the principal place from which the trade or business of the taxpayer is directed or managed.

(3) **"Compensation"** means wages, salaries, commissions and any other form of remuneration paid to employees for personal services.

(4) **"Financial organization"** means any bank, trust company, savings bank, industrial bank, land bank, safe deposit company, private banker, savings and loan association, credit union, cooperative bank, small loan company, sales finance company, investment company, or any type of insurance company.

(5) **"Nonbusiness income"** means all income other than business income.

(6) **"Public utility"** means any business entity

(a) which owns or operates any plant, equipment, property, franchise, or license for the transmission of communications, transportation of goods or persons, except by pipe line, or

the production, transmission, sale, delivery, or furnishing of electricity, water or steam; and

(b) whose rates of charges for goods or services have been established or approved by a federal, state or local government or governmental agency.

(7) **"Sales"** means all gross receipts of the taxpayer not allocated under paragraphs of this article.

(8) **"State"** means any state of the United States, the District of Columbia, the commonwealth of Puerto Rico, any territory or possession of the United States, and any foreign country or political subdivision thereof.

(9) **"This state"** means the state in which the relevant tax return is filed or, in the case of application of this article, to the apportionment and allocation of income for local tax purposes, the subdivision or local taxing district in which the relevant tax return is filed.

2. Any taxpayer having income from business activity which is taxable both within and without this state, other than activity as a financial organization or public utility or the rendering of purely personal services by an individual, shall allocate and apportion his net income as provided in this article. If a taxpayer has income from business activity as a public utility but derives the greater percentage of his income from activities subject to this article, the taxpayer may elect to allocate and apportion his entire net income as provided in this article.

3. For purposes of allocation and apportionment of income under this article, a taxpayer is taxable in another state if

(1) in that state he is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or corporate stock tax; or

(2) that state has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the state does or does not.

4. Rents and royalties from real or tangible personal property, capital gains, interest, dividends or patent or copyright royalties, to the extent that they constitute non-business income, shall be allocated as provided in paragraphs 5 through 8 of this article.

5. (1) Net rents and royalties from property located in this state are not allocable to this state.

(2) Net rents and royalties from tangible personal property are allocable to this state:

(a) if and to the extent that the property is utilized in this state; or

(b) in their entirety if the taxpayer's commercial domicile is in this state and the taxpayer is not organized under the laws of or taxable in the state in which the property is utilized.

(3) The extent of utilization of tangible personal property in a state is determined by multiplying the rents and royalties by a fraction, the numerator of which is the number of days of physical location of the property in the state during the rental or royalty period in the taxable year and the denominator of which is the number of days of physical location of the property everywhere during all rental or royalty periods in the taxable year. If the physical location of the property during the rental or royalty period is unknown or unascertainable by the

taxpayer, tangible personal property is utilized in the state in which the property was located at the time the rental or royalty payer obtained possession.

6. (1) Capital gains and losses from sales of real property located in this state are allocable to this state.

(2) Capital gains and losses from sales of tangible personal property are allocable to this state if

(a) the property had a situs in this state at the time of the sale; or

(b) the taxpayer's commercial domicile is in this state and the taxpayer is not taxable in the state in which the property had a situs.

(3) Capital gains and losses from sales of intangible personal property are allocable to this state if the taxpayer's commercial domicile is in this state.

7. Interest and dividends are allocable to this state if the taxpayer's commercial domicile is in this state.

8. (1) Patent and copyright royalties are allocable to this state:

(a) if and to the extent that the patent or copyright is utilized by the payer in this state; or

(b) if and to the extent that the patent copyright is utilized by the payer in a state in which the taxpayer is not taxable and the taxpayer's commercial domicile is in this state.

(2) A patent is utilized in a state to the extent that it is employed in production, fabrication, manufacturing, or other processing in the state or to the extent that a patented product is produced in the state. If the basis of

receipts from patent royalties does not permit allocation to states or if the accounting procedures do not reflect states of utilization, the patent is utilized in the state in which the taxpayer's commercial domicile is located.

(3) A copyright is utilized in a state to the extent that printing or other publication originates in the state. If the basis of receipts from copyright royalties does not permit allocation to states or if the accounting procedures do not reflect states of utilization, the copyright is utilized in the state in which the taxpayer's commercial domicile is located.

9. All business income shall be apportioned to this state by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three.

10. The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in this state during the tax period and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used during the tax period.

11. Property owned by the taxpayer is valued at is original cost. Property rented by the taxpayer is valued at eight times the net annual rental rate. Net annual rental rate is the annual rental rate paid by the taxpayer less any annual rental rate received by the taxpayer from subrentals.

12. The average value of property shall be determined by averaging the values at the beginning and ending of the tax period but the tax administrator may require the averaging of monthly values during the tax period if reasonably required to reflect properly the average value of the taxpayer's property.

13. The payroll factor is a fraction, the numerator of which is the total amount paid in this state during the tax period by the taxpayer for compensation and the denominator of which is the total compensation paid everywhere during the tax period.

14. Compensation is paid in this state if:

(1) the individual's service is performed entirely within the state,

(2) the individual's service is performed both within and without the state, but the service performed without the state is incidental to the individual's service within the state; or

(3) some of the service is performed in the state; and

> (a) the base of operations or, if there is no base of operations, the place from which the service is directed or controlled is in the state; or
>
> (b) the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in this state.

15. The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during

the tax period, and the denominator of which is the total sales of the taxpayer everywhere during the tax period.

16. Sales of tangible personal property are in this state if:

(1) the property is delivered or shipped to a purchaser, other than the United States government, within this state regardless of the f.o.b. point or other conditions of the sale; or

(2) the property is shipped from an office, store, warehouse, factory, or other place of storage in this state; and

(a) the purchaser is the United States government; or

(b) the taxpayer is not taxable in the state of the purchaser.

17. Sales, other than sales of tangible personal property, are in this state if:

(1) the income-producing activity is performed in this state; or

(2) the income-producing activity is performed both in and outside this state and a greater proportion of the income-producing activity is performed in this state than in any other state, based on costs of performance.

18. If the allocation and apportionment provisions of this article do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the tax administrator may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

(1) separate accounting;

(2) the exclusion of any one or more of the factors;

(3) the inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or

(4) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

Article V

1. Each purchaser liable for a use tax on tangible personal property shall be entitled to full credit for the combined amount or amounts of legally imposed sales or use taxes paid by him with respect to the same property to another state and any subdivision thereof. The credit shall be applied first against the amount of any use tax due the state, and any unused portion of the credit shall then be applied against the amount of any use tax due a subdivision.

2. Whenever a vendor receives and accepts in good faith from a purchaser a resale or other exemption certificate or other written evidence of exemption authorized by the appropriate state or subdivision taxing authority, the vendor shall be relieved of liability for a sales or use tax with respect to the transaction.

Article VI

1. (a) The multistate tax commission is hereby established. It shall be composed of one "member" from

each party state who shall be the head of the state agency charged with the administration of the types of taxes to which this compact applies. If there is more than one such agency the state shall provide by law for the selection of the commission member from the heads of the relevant agencies. State law may provide that a member of the commission be represented by an alternate but only if there is on file with the commission written notification of the designation and identity of the alternate. The attorney general of each party state or his designee, or other counsel if the laws of the party state specifically provide, shall be entitled to attend the meetings of the commission, but shall not vote. Such attorneys general, designees, or other counsel shall receive all notices of meetings required under paragraph 1(e) of this article.

(b) Each party state shall provide by law for the selection of representatives from its subdivisions affected by this compact to consult with the commission member from that state.

(c) Each member shall be entitled to one vote. The commission shall not act unless a majority of the members are present, and no action shall be binding unless approved by a majority of the total number of members.

(d) The commission shall adopt an official seal to be used as it may provide.

(e) The commission shall hold an annual meeting and such other regular meetings as its bylaws may provide and such special meetings as its executive committee may determine. The commission bylaws shall specify the dates of the annual and any other regular meetings, and shall provide for the giving of notice of annual, regular

and special meetings. Notices of special meetings shall include the reasons therefor and an agenda of the items to be considered.

(f) The commission shall elect annually, from among its members, a chairman, a vice-chairman and a treasurer. The commission shall appoint an executive director who shall serve at its pleasure, and it shall fix his duties and compensation. The executive director shall be secretary of the commission. The commission shall make provision for the bonding of such of its officers and employees as it may deem appropriate.

(g) Irrespective of the civil service, personnel or other merit system laws of any party state, the executive director shall appoint or discharge such personnel as may be necessary for the performance of the functions of the commission and shall fix their duties and compensation. The commission bylaws shall provide for personnel policies and programs.

(h) The commission may borrow, accept or contract for the services of personnel from any state, the United States, or any other governmental entity.

(i) The commission may accept for any of its purposes and functions any and all donations and grants of money, equipment, supplies, materials and services, conditional or otherwise, from any governmental entity, and may utilize and dispose of the same.

(j) The commission may establish one or more offices for the transacting of its business.

(k) The commission shall adopt bylaws for the conduct of its business. The commission shall publish its

bylaws in convenient form, and shall file a copy of the bylaws and any amendments thereto with the appropriate agency or officer in each of the party states.

(*l*) The commission annually shall make to the governor and legislature of each party state a report covering its activities for the preceding year. Any donation or grant accepted by the commission or services borrowed shall be reported in the annual report of the commission, and shall include the nature, amount and conditions, if any, of the donation, gift, grant or services borrowed and the identity of the donor or lender. The commission may make additional reports as it may deem desirable.

2. (a) To assist in the conduct of its business when the full commission is not meeting, the commission shall have an executive committee of seven members, including the chairman, vice-chairman, treasurer and four other members elected annually by the commission. The executive committee, subject to the provisions of this compact and consistent with the policies of the commission, shall function as provided in the bylaws of the commission.

(b) The commission may establish advisory and technical committees, membership on which may include private persons and public officials, in furthering any of its activities. Such committees may consider any matter of concern to the commission, including problems of special interest to any party state and problems dealing with particular types of taxes.

(c) The commission may establish such additional committees as its bylaws may provide.

3. In addition to powers conferred elsewhere in this compact, the commission shall have power to:

(a) Study state and local tax systems and particular types of state and local taxes.

(b) Develop and recommend proposals for an increase in uniformity or compatibility of state and local tax laws with a view toward encouraging the simplification and improvement of state and local tax law and administration.

(c) Compile and publish information as in its judgment would assist the party states in implementation of the compact and taxpayers in complying with state and local tax laws.

(d) Do all things necessary and incidental to the administration of its functions pursuant to this compact.

(4) (a) The commission shall submit to the governor or designated officer or officers of each party state a budget of its estimated expenditures for such period as may be required by the laws of that state for presentation to the legislature thereof.

(b) Each of the commission's budgets of estimated expenditures shall contain specific recommendations of the amounts to be appropriated by each of the party states. The total amount of appropriations requested under any such budget shall be apportioned among the party states as follows: one-tenth in equal shares; and the remainder in proportion to the amount of revenue collected by each party state and its subdivisions from income taxes, capital stock taxes, gross receipts taxes, sales and use taxes. In determining such amounts, the

commission shall employ such available public sources of information as, in its judgment, present the most equitable and accurate comparisons among the party states. Each of the commission's budgets of estimated expenditures and requests for appropriations shall indicate the sources used in obtaining information employed in applying the formula contained in this paragraph.

(c) The commission shall not pledge the credit of any party state. The commission may meet any of its obligations in whole or in part with funds available to it under paragraph 1 (i) of this article; provided that the commission takes specific action setting aside such funds prior to incurring any obligation to be met in whole or in part in such manner. Except where the commission makes use of funds available to it under paragraph 1(i), the commission shall not incur any obligation prior to the allotment of funds by the party states adequate to meet the same.

(d) The commission shall keep accurate accounts of all receipts and disbursements. The receipts and disbursements of the commission shall be subject to the audit and accounting procedures established under its bylaws. All receipts and disbursements of funds handled by the commission shall be audited yearly by a certified or licensed public accountant and the report of the audit shall be included in and become part of the annual report of the commission.

(e) The accounts of the commission shall be open at any reasonable time for inspection by duly constituted officers of the party states and by any persons authorized by the commission.

(f) Nothing contained in this article shall be construed to prevent commission compliance with laws relating to audit or inspection of accounts by or on behalf of any government contributing to the support of the commission.

Article VII

1. Whenever any two or more party states, or subdivisions of party states, have uniform or similar provisions of law relating to an income tax, capital stock tax, gross receipts tax, sales or use tax, the commission may adopt uniform regulations for any phase of the administration of such law, including assertion of jurisdiction to tax, or prescribing uniform tax forms. The commission may also act with respect to the provisions of article IV of this compact.

2. Prior to the adoption of any regulation, the commission shall:

(a) As provided in its bylaws, hold at least one public hearing on due notice to all affected party states and subdivisions thereof and to all taxpayers and other persons who have made timely request of the commission for advance notice of its regulation-making proceedings.

(b) Afford all affected party states and subdivisions and interested persons an opportunity to submit relevant written data and views, which shall be considered fully by the commission.

3. The commission shall submit any regulations adopted by it to the appropriate officials of all party states and subdivisions to which they might apply. Each

such state and subdivision shall consider any such regulation for adoption in accordance with its own laws and procedures.

Article VIII

1. This article shall be in force only in those party states that specifically provide therefor by statute.

2. Any party state or subdivision thereof desiring to make or participate in an audit of any accounts, books, papers, records or other documents may request the commission to perform the audit on its behalf. In responding to the request, the commission shall have access to and may examine, at any reasonable time, such accounts, books, papers, records, and other documents and any relevant property or stock of merchandise. The commission may enter into agreements with party states or their subdivisions for assistance in performance of the audit. The commission shall make charges, to be paid by the state or local government or governments for which it performs the service, for any audits performed by it in order to reimburse itself for the actual costs incurred in making the audit.

3. The commission may require the attendance of any person within the state where it is conducting an audit or part thereof at a time and place fixed by it within such state for the purpose of giving testimony with respect to any account, book, paper, document, other record, property or stock of merchandise being examined in connection with the audit. If the person is not within the jurisdiction, he may be required to attend for such purpose at any time and place fixed by the commission

within the state of which he is a resident; provided that such state has adopted this article.

4. The commission may apply to any court having power to issue compulsory process for orders in aid of its powers and responsibilities pursuant to this article and any and all such courts shall have jurisdiction to issue such orders. Failure of any person to obey any such order shall be punishable as contempt of the issuing court. If the party or subject matter on account of which the commission seeks an order is within the jurisdiction of the court to which application is made, such application may be to a court in the state or subdivision on behalf of which the audit is being made or a court in the state in which the object of the order being sought is situated. The provisions of this paragraph apply only to courts in a state that has adopted this article.

5. The commission may decline to perform any audit requested if it finds that its available personnel or other resources are insufficient for the purpose or that, in the terms requested, the audit is impracticable of satisfactory performance. If the commission, on the basis of its experience, has reason to believe that an audit of a particular taxpayer, either at a particular time or on a particular schedule, would be of interest to a number of party states or their subdivisions, it may offer to make the audit or audits, the offer to be contingent on sufficient participation therein as determined by the commission.

6. Information obtained by an audit pursuant to this article shall be confidential and available only for tax purposes to party states, their subdivisions or the United States. Availability of information shall be in accordance

with the laws of the states or subdivisions on whose account the commission performs the audit, and only through the appropriate agencies or officers of such states or subdivisions. Nothing in this article shall be construed to require any taxpayer to keep records for any period not otherwise required by law.

7. Other arrangements made or authorized pursuant to law for cooperative audit by or on behalf of the party states or any of their subdivisions are not superseded or invalidated by this article.

8. In no event shall the commission make any charge against a taxpayer for an audit.

9. As used in this article, **"tax"** in addition to the meaning ascribed to it in article II, means any tax or license fee imposed in whole or in part for revenue purposes.

Article IX

1. Whenever the commission finds a need for settling disputes concerning apportionments and allocations by arbitration, it may adopt a regulation placing this article in effect, notwithstanding the provisions of article VII.

2. The commission shall select and maintain an arbitration panel composed of officers and employees of state and local governments and private persons who shall be knowledgeable and experienced in matters of tax law and administration.

3. Whenever a taxpayer who has elected to employ article IV, or whenever the laws of the party state or

subdivision thereof are substantially identical with the relevant provisions of article IV, the taxpayer, by written notice to the commission and to each party state or subdivision thereof that would be affected, may secure arbitration of an apportionment or allocation, if he is dissatisfied with the final administration determination of the tax agency of the state or subdivision with respect thereto on the ground that it would subject him to double or multiple taxation by two or more party states or subdivisions thereof. Each party state and subdivision thereof hereby consents to the arbitration as provided herein, and agrees to be bound thereby.

4. The arbitration board shall be composed of one person selected by the taxpayer, one by the agency or agencies involved, and one member of the commission's arbitration panel. If the agencies involved are unable to agree on the person to be selected by them, such person shall be selected by lot from the total membership of the arbitration panel. The two persons selected for the board in the manner provided by the foregoing provisions of this paragraph shall jointly select the third member of the board. If they are unable to agree on the selection, the third member shall be selected by lot from among the total membership of the arbitration panel. No member of a board selected by lot shall be qualified to serve if he is an officer or employee or is otherwise affiliated with any party to the arbitration proceeding. Residence within the jurisdiction of a party to the arbitration proceeding shall not constitute affiliation within the meaning of this paragraph.

5. The board may sit in any state or subdivision party to the proceeding, in the state of the taxpayer's

incorporation, residence or domicile, in any state where the taxpayer does business, or in any place that it finds most appropriate for gaining access to evidence relevant to the matter before it.

6. The board shall give due notice of the times and places of its hearings. The parties shall be entitled to be heard, to present evidence, and to examine and cross-examine witnesses. The board shall act by majority vote.

7. The board shall have power to administer oaths, take testimony, subpoena and require the attendance of witnesses and the production of accounts, books, papers, records, and other documents, and issue commissions to take testimony. Subpoenas may be signed by any member of the board. In case of failure to obey a subpoena, and upon application by the board, any judge of a court of competent jurisdiction of the state in which the board is sitting or in which the person to whom the subpoena is directed may be found may make an order requiring compliance with the subpoena, and the court may punish failure to obey the order as a contempt. The provisions of this paragraph apply only in states that have adopted this article.

8. Unless the parties otherwise agree the expenses and other costs of the arbitration shall be assessed and allocated among the parties by the board in such manner as it may determine. The commission shall fix a schedule of compensation for members of arbitration boards and of other allowable expenses and costs. No officer or employee of a state or local government who serves as a member of a board shall be entitled to compensation therefor unless he is required on account of his service to

forego the regular compensation attaching to his public employment, but any such board member shall be entitled to expenses.

9. The board shall determine the disputed apportionment or allocation and any matters necessary thereto. The determinations of the boards shall be final for purposes of making the apportionment or allocation, but for no other purpose.

10. The board shall file with the commission and with each tax agency represented in the proceeding: the determination of the board; the board's written statement of its reasons therefor; the record of the board's proceedings; and any other documents required by the arbitration rules of the commission to be filed.

11. The commission shall publish the determinations of boards together with the statements of the reasons therefor.

12. The commission shall adopt and publish rules of procedure and practice and shall file a copy of such rules and of any amendment thereto with the appropriate agency or officer in each of the party states.

13. Nothing contained herein shall prevent at any time a written compromise of any matter or matters in dispute, if otherwise lawful, by the parties to the arbitration proceeding.

Article X

1. This compact shall enter into force when enacted into law by any seven states. Thereafter, this compact shall become effective as to any other state upon its

enactment thereof. The commission shall arrange for notification of all party states whenever there is a new enactment of the compact.

2. Any party state may withdraw from this compact by enacting a statute repealing the same. No withdrawal shall affect any liability already incurred by or chargeable to a party state prior to the time of such withdrawal.

3. No proceeding commenced before an arbitration board prior to the withdrawal of a state and to which the withdrawing state or any subdivision thereof is a party shall be discontinued or terminated by the withdrawal, nor shall the board thereby lose jurisdiction over any of the parties to the proceeding necessary to make a binding determination therein.

Article XI

Nothing in this compact shall be construed to:

(a) Affect the power of any state or subdivision thereof to fix rates of taxation, except that a party state shall be obligated to implement article III 2 of this compact.

(b) Apply to any tax or fixed fee imposed for the registration of a motor vehicle or any tax on motor fuel, other than a sales tax; provided that the definition of "tax" in article VIII 9 may apply for the purposes of that article and the commission's powers of study and recommendation pursuant to article VI 3 may apply.

(c) Withdraw or limit the jurisdiction of any state or local court or administrative officer or body with respect to any person, corporation or other entity or subject

matter, except to the extent that such jurisdiction is expressly conferred by or pursuant to this compact upon another agency or body.

(d) Supersede or limit the jurisdiction of any court of the United States.

Article XII

This compact shall be liberally construed so as to effectuate the purposes thereof. The provisions of this compact shall be severable and if any phrase, clause, sentence or provision of this compact is declared to be contrary to the constitution of any state or of the United States or the applicability thereof to any government, agency, person or circumstance is held invalid, the validity of the remainder of this compact and the applicability thereof to any government, agency, person or circumstance shall not be affected thereby. If this compact shall be held contrary to the constitution of any state participating therein, the compact shall remain in full force and effect as to the remaining party states and in full force and effect as to the state affected as to all severable matters. (L.1967 p. 102 § 1)

143.071. Corporations

A tax is hereby imposed upon the Missouri taxable income of corporations in an amount equal to five percent of Missouri taxable income.

(Added by L.1972 p. 699 § A eff. Jan. 1, 1973)

143.091. Meaning of terms

Any term used in sections 143.011 to 143.996 shall have the same meaning as when used in a comparable context in the laws of the United States relating to federal income taxes, unless a different meaning is clearly required by the provisions of sections 143.011 to 143.996. Any reference in sections 143.011 to 143.996 to the laws of the United States shall mean the provisions of the Internal Revenue Code of 1954,[1] and amendments thereto, and other provisions of the laws of the United States relating to federal income taxes, as the same may be or become effective, at any time or from time to time, for the taxable year.

(Added by L.1972 p. 699 § A eff. Jan. 1, 1973)

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[1] 26 U.S.C.A. (I.R.C.1954) § 1 et seq.

143.431. Missouri taxable income and tax

1. The Missouri taxable income of a corporation taxable under sections 143.011 to 143.996 shall be so much of its federal taxable income for the taxable year, with the modifications specified in subsections 2 and 3 of this section, as is derived from sources within Missouri as provided in section 143.451. The tax of a corporation shall be computed on its Missouri taxable income at the rates provided in section 143.071.

2. There shall be added to or subtracted from federal taxable income, the modifications to adjusted gross income provided in section 143.121 and the applicable modifications to itemized deductions provided in section 143.141. There shall be subtracted the federal income tax deduction provided in section 143.171. There shall be subtracted, to the extent included in federal taxable income, corporate dividends from sources within Missouri.

3. (1) If an affiliated group of corporations files a consolidated income tax return for the taxable year for federal income tax purposes and fifty percent or more of its income is derived from sources within this state as determined in accordance with section 143.451, then it may elect to file a Missouri consolidated income tax return. The federal consolidated taxable income of the electing affiliated group for the taxable year shall be its federal taxable income.

(2) So long as a federal consolidated income tax return is filed, an election made by an affiliated group of corporations to file a Missouri consolidated income tax return may be withdrawn or revoked only upon substantial change in the law or regulations adversely changing

tax liability under this chapter; or, with permission of the director of revenue upon the showing of good cause for such action. After such a withdrawal or revocation with respect to an affiliated group, it may not file a Missouri consolidated income tax return for five years thereafter, except with the approval of the director of revenue, and subject to such terms and conditions as he may prescribe.

(3) No corporation which is part of an affiliated group of corporations filing a Missouri consolidated income tax return shall be required to file a separate Missouri corporate income tax return for the taxable year.

(4) For each taxable year an affiliated group of corporations filing a federal consolidated income tax return does not file a Missouri consolidated income tax return, for purposes of computing the Missouri income tax, the federal taxable income of each member of the affiliated group shall be determined as if a separate federal income tax return had been filed by each such member.

(5) The director of revenue may prescribe such regulations not inconsistent with the provisions of this chapter as he may deem necessary in order that the tax liability of any affiliated group of corporations making a Missouri consolidated income tax return, and of each corporation in the group, before, during, and after the period of affiliation, may be returned, determined, computed, assessed, collected, and adjusted, in such manner as clearly to reflect the Missouri taxable income derived from sources within this state and in order to prevent avoidance of such tax liability.

(Added by L.1972 p. 699 § A eff. Jan. 1, 1973)

143.451. Division of interstate income

1. Missouri taxable income of a corporation shall include all income derived from sources within this state.

2. A corporation described in subdivision (1) of subsection 1 of section 143.441 shall include in its Missouri taxable income all income from sources within this state, including that from the transaction of business in this state and that from the transaction of business partly done in this state and partly done in another state or states. However:

(1) Where income results from a transaction partially in this state and partially in another state or states, and income and deductions of the portion in the state cannot be segregated, then such portions of income and deductions shall be allocated in this state and other state or states as will distribute to this state a portion based upon the portion of the transaction in this state and the portion in such other state or states.

(2) The taxpayer may elect to compute the portion of income from all sources in this state in the following manner:

(a) The income from all sources shall be determined as provided, excluding therefrom the figures for the operation of any bridge connecting this state with another state.

(b) The amount of sales which are transactions wholly in this state shall be added to one-half of the amount of sales which are transactions partly within this state and partly without this state, and the amount thus obtained shall be divided by the total sales or in cases where sales do not express the volume of business, the amount of business transacted wholly in this state shall

be added to one-half of the amount of business transacted partly in this state and partly outside this state and the amount thus obtained shall be divided by the total amount of business transacted, and the net income shall be multiplied by the fraction thus obtained, to determine the proportion of income to be used to arrive at the amount of Missouri taxable income. The investment or reinvestment of its own funds, or sale of any such investment or reinvestment, shall not be considered as sales or other business transacted for the determination of said fraction.

3. Any corporation described in subdivision (1) of subsection 1 of section 143.441 organized in this state or granted a permit to operate in this state for the transportation or care of passengers shall report its gross earnings within the state on intrastate business and shall also report its gross earnings on all interstate business done in this state which report shall be subject to inquiry for the purpose of determining the amount of income to be included in Missouri taxable income. The previous sentence shall not apply to a railroad.

4. A corporation described in subdivision (2) of subsection 1 of section 143.441 shall include in its Missouri taxable income all income arising from all sources in this state and all income from each transportation service wholly within this state, from each service where the only lines of such corporation used are those in this state, and such proportion of revenue from each service where the facilities of such corporation in this state and in another state or states are used, as the mileage used over the lines of such corporation in the state shall bear to the total mileage used over the lines of such corporation. The

taxpayer may elect to compute the portion of income from all sources within this state in the following manner:

(1) The income from all sources shall be determined as provided.

(2) The amount of investment of such corporation on December thirty-first of each year in this state in fixed transportation facilities, real estate and improvements, plus the value on December thirty-first of each year of any fixed transportation facilities, real estate and improvements in this state leased from any other railroad shall be divided by the sum of the total amount of investment of such corporation on December thirty-first of each year in fixed transportation facilities, real estate and improvements, plus the value on December thirty-first of each year, of any fixed transportation facilities, real estate and improvements leased from any other railroad. Where any fixed transportation facilities, real estate or improvements are leased by more than one railroad, such portion of the value shall be used by each railroad as the rental paid by each shall bear to the rental paid by all lessees. The income shall be multiplied by the fraction thus obtained to determine the proportion to be used to arrive at the amount of Missouri taxable income.

5. A corporation described in subdivision (3) of subsection 1 of section 143.441 shall include in its Missouri taxable income one-half of the net income from the operation of a bridge between this and another state. If any such bridge is owned or operated by a railroad corporation or corporations, or by a corporation owning a railroad corporation using such bridge, then the figures for operation of such bridge may be included in the return of

such railroad or railroads; or if such bridge is owned or operated by any other corporation which may now or hereafter be required to file an income tax return, one-half of the income or loss to such corporation from such bridge may be included in such return by adding or subtracting same to or from another net income or loss shown by the return.

6. A corporation described in subdivision (4) of subsection 1 of section 143.441 shall include in its Missouri taxable income all income arising from all sources within this state. Income shall include revenue from each telephonic or telegraphic service rendered wholly within this state; from each service rendered for which the only facilities of such corporation used are those in this state; and from each service rendered over the facilities of such corporation in this state and in other state or states, such proportion of such revenue as the mileage involved in this state shall bear to the total mileage involved over the lines of said company in all states. The taxpayer may elect to compute the portion of income from all sources within this state in the following manner:

(1) The income from all sources shall be determined as provided.

(2) The amount of investment of such corporation on December thirty-first of each year in this state in telephonic or telegraphic facilities, real estate and improvements thereon, shall be divided by the amount of the total investment of such corporation on December thirty-first of each year in telephonic or telegraphic facilities, real estate and improvements. The income of the taxpayer shall be multiplied by fraction thus obtained to

determine the proportion to be used to arrive at the amount of Missouri taxable income.

7. From the income determined in subsections 2, 3, 4, 5 and 6 of this section to be from all sources within this state shall be deducted such of the deductions for expenses in determining Missouri taxable income as were incurred in this state to produce such income and all losses actually sustained in this state in the business of the corporation.

8. If a corporation derives only part of its income from sources within Missouri, its Missouri taxable income shall only reflect the effect of the following listed deductions to the extent applicable to Missouri. The deductions are: (a) its deduction for federal income taxes pursuant to section 143.171, and (b) the effect on Missouri taxable income of the deduction for net operating loss allowed by Section 172 of the Internal Revenue Code.[1] The extent applicable to Missouri shall be determined by multiplying the amount that would otherwise affect Missouri taxable income by the ratio for the year of the Missouri taxable income of the corporation for the year divided by the Missouri taxable income for the year as though the corporation had derived all of its income from sources within Missouri. For the purpose of the preceding sentence, Missouri taxable income shall not reflect the listed deductions.

(Added by L.1972 p. 699 § A eff. Jan. 1, 1973)

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[1] 26 U.S.C.A. (I.R.C.1954) § 172.

IN THE SUPREME COURT OF MISSOURI

THE WILLIAMS COMPANIES, INC. AND ITS DOMESTIC SUBSIDIARIES, INCLUDING WILLIAMS NATURAL GAS COMPANY, WILLIAMS PIPE LINE COMPANY, WRC OF MISSOURI, INC., AGRICO CHEMICAL COMPANY, WILLCO, INC. (EDGCOMB METALS COMPANY), WILBROS TERMINAL COMPANY, AND WRC OF CROWN CENTER, INC.,	)	CASE NO. ___ Filed Jan. 10, 1990
Appellants,	)	
v.	)	
DIRECTOR OF REVENUE, STATE OF MISSOURI,	)	
Respondent.	)	

PETITION FOR REVIEW
OF ADMINISTRATIVE DECISION

COMES NOW The Williams Companies, Inc. and its domestic subsidiaries, including Williams Natural Gas Company, Williams Pipe Line Company, WRC of Missouri, Inc., Agrico Chemical Company, Willco, Inc. (Edgcomb Metals Company), Wilbros Terminal Company and WRC of Crown Center, Inc., collectively the Appellants, by and through their undersigned counsel, pursuant to art. 5, § 3 of the Missouri Constitution; § 621.189, RSMo 1988; Administrative Hearing Commission Rule 1 CSR 15-3.110; and Supreme Court Rule 100.2; and file this Petition for Review of Administrative Decision with the

Supreme Court of Missouri for review of the final decision of the Administrative Hearing Commission (the "Commission") dated December 12, 1989; and further state as follows:

1. Appellants are aggrieved by the final decision of the Commission filed and mailed on December 12, 1989, a copy of which is attached hereto and made a part hereof as Exhibit A.

2. Appellants' claim for review arises from the Commission's construction of the following revenue laws of the State of Missouri: (a) § 143.431, RSMo 1976, and § 32.200, Art. IV, subd. 1(1), 9, RSMo 1969, regarding a taxpayer's ability to file combined or consolidated income tax returns, as it applies to the Appellants' claim for refund of income taxes for the tax years 1982 through 1984; and (b) § 32.200, Art. IV, § 1(1), RSMo 1969, as it applies to the interest income of Williams Natural Gas Company ("WNG") for the tax years 1982 through 1985 and the capital gain income of Williams Pipe Line Company ("WPL") for the tax year 1984.

3. This case was initiated by the Appellants' filing with the Director of Revenue of a claim for refund of corporation income tax for the tax periods 1982 through 1984 on January 22, 1987, and by the issuance of (a) a Final Notice of State Income Tax Deficiency to WPL on November 25, 1986, for tax year 1984, (b) two Final Notices of State Income Tax Deficiency issued to WNG on November 26, 1986, for the tax periods ending November 12, 1982 and December 31, 1982, (c) three Final Notices of State Income Tax Deficiency issued to WNG on December 9, 1986, for the tax periods ending October 7, 1983,

December 31, 1983, and December 31, 1984, and (d) a Final Notice of State Income Tax Deficiency to WNG on February 9, 1987, with respect to the 1985 tax year.

4. Appellants timely protested all four of the Final Notices of State Income Tax Deficiency. On February 24, 1988, Respondent issued its final decision upholding the Notices and denying Appellants' refund claim. On March 23, 1988, Appellants timely filed their Complaint before the Commission. Appellants thereafter filed their First Amended Complaint on August 12, 1988, seeking the Commission's determination that Respondent erroneously assessed deficiencies of corporate income tax for the years 1982 through 1985 and improperly denied Appellants' refund claim for tax years 1982 through 1984. A copy of said First Amended Complaint is attached hereto and made a part hereof as Exhibit B.

5. The Commission held a Hearing on the Complaint on November 23, 1988, and issued its final decision on December 12, 1989. The decision of the Commission rendered on December 12, 1989, was adverse to Appellants and Appellants have exhausted their administrative remedies. Judicial review of the decision of the Commission lies in this Court pursuant to art. V, § 3 of the Missouri Constitution; and § 621.189, RSMo 1988.

6. Three issues invoke the exclusive appellate jurisdiction of this Court, all of which were raised in the proceedings before Respondent and the Commission, and are as follows:

(a) Whether Appellants, as a unitary business, are entitled to report their Missouri corporate income on a combined or consolidated basis, pursuant to § 143.431,

RSMo 1976; § 32.200, Art. IV, subd. 1(1), 9, RSMo 1969; the Commerce Clause of the United States Constitution, U.S. Const. art I, sec. 8, Cl. 3; the Due Process Clause of the United States Constitution, U.S. Const. Amend. XIV; the Uniformity Clause of the Missouri Constitution, Mo. Const. art. 10, Sec. 3; and the Equal Protection Clause of the Missouri Constitution, Mo. Const. art. 1, Sec. 2;

(b) Whether WNG's interest income from funds loaned to its corporate parent under demand notes was non-business income, i.e., income not arising from transactions and activities in the regular course of the taxpayer's trade or business, pursuant to § 32.200, Art. IV, § 1(1), RSMo 1988, and accordingly, is not taxable by the State of Missouri under such revenue statute and the Due Process Clause of the United States Constitution, U.S. Const. Amend. XIV; and

(c) Whether WPL's capital gains income from the sale of a stock investment in an unrelated, discreet enterprise entitled Wood River Pipeline Corporation was non-business income, i.e., income not arising from transactions and activities in the regular course of the taxpayer's trade or business, pursuant to § 32.200, Art. IV, § 1(1), RSMo., 1988, and accordingly, is not taxable by the State of Missouri under such revenue statute and the Due Process Clause of the United States Constitution, U.S. Const. Amend. XIV.

7. Appellants are not seeking review of that portion of the decision of the Commission holding that interest from WNG's short-term investments in "repos", or security repurchase transactions, did not constitute business

income and, accordingly, is not taxable by the State of Missouri.

8. The findings and conclusions of the Commission that the Notices of State Income Tax Deficiencies against WPL and WNG should be upheld and that the refund request of Appellants should be denied, were erroneous and, upon review by this Court, such findings and conclusions should be reversed.

WHEREFORE, Appellants petition this Court to assume jurisdiction over Appellants' claim and to render a decision reversing the judgment of the Commission, declaring that Appellants' refund claim should be upheld and that Respondent's Notices of State Income Tax Deficiency should be denied.

Respectfully submitted,

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THE WILLIAMS COMPANIES, INC.,
AND ITS DOMESTIC SUBSIDIARIES

CERTIFICATE OF SERVICE

This is to certify that on the 10th day of January, 1990, I hand-delivered or mailed a true and correct copy of the above and foregoing PETITION FOR REVIEW OF ADMINISTRATIVE DECISION, with proper postage thereon fully prepaid, addressed to:

Mr. Duane Benton
Director of Revenue
State of Missouri
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Jefferson City, MO 65105

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/s/ J. Kent Lowry
J. Kent Lowry

No. 90-1458

FILED
JUN 6 1991
OFFICE OF THE CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

THE WILLIAMS COMPANIES, INC. and ITS DOMESTIC SUBSIDIARIES, including WILLIAMS NATURAL GAS COMPANY, WILLIAMS PIPE LINE COMPANY, WRC OF MISSOURI, INC., AGRICO CHEMICAL COMPANY, WILLCO, INC. (EDGCOMB METALS COMPANY), WILLBROS TERMINAL COMPANY, and WRC OF CROWN CENTER, INC.,

Petitioners,

vs.

DIRECTOR OF REVENUE, STATE OF MISSOURI,

Respondent.

On Petition for a Writ of Certiorari
to the Supreme Court of Missouri

RESPONDENT'S BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

Respondent submits that the instant case presents the following questions:

1. Whether the Missouri Supreme Court erred in upholding the Director of Revenue's denial of the petitioners' request for permission to file amended returns on a consolidated basis where (1) petitioners had previously filed separate Missouri corporate income tax returns for the years in question and (2) petitioners did not meet the Missouri statutory requirements for filing a consolidated return?

2. Whether the Missouri Supreme Court erred in upholding the Director of Revenue's assessment, which apportions capital gain income derived from the sale of stock to Missouri under the Multistate Tax Compact, based on its finding that the seller and the issuing corporation constituted a unitary business, where the seller did not own a controlling stock interest in the issuing corporation, but under the facts of the case, did exert actual control over the issuing corporation?

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No.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

THE WILLIAMS COMPANIES, INC. and ITS DOMESTIC SUBSIDIARIES, including WILLIAMS NATURAL GAS COMPANY, WILLIAMS PIPE LINE COMPANY, WRC OF MISSOURI, INC., AGRICO CHEMICAL COMPANY, WILLCO, INC. (EDGCOMB METALS COMPANY), WILLBROS TERMINAL COMPANY, and WRC OF CROWN CENTER, INC.,

Petitioners,

VS.

DIRECTOR OF REVENUE, STATE OF MISSOURI,

Respondent.

On Petition for a Writ of Certiorari
to the Supreme Court of Missouri

RESPONDENT'S BRIEF IN OPPOSITION

The respondent, Duane Benton, Director of Revenue of the State of Missouri, respectfully requests this Court to deny the Petition for Writ of Certiorari, seeking review of the decision of the Supreme Court of Missouri in this case. That opinion is reported at 799 S.W.2d 602 (Mo. banc 1990).

REASONS WHY THE PETITION SHOULD BE DENIED

1. The decision of the Supreme Court of Missouri concerning the Missouri statutory requirements for filing a Missouri consolidated income tax return can be sustained on an independent ground of state law, as demonstrated by the decision of the Missouri Administrative Hearing Commission herein, and therefore, resolution of this case would not require this Court to decide any substantial federal questions.

The Missouri statutory provision at issue in this case, § 143.431.3(1), Revised Statutes of Missouri ("R.S.Mo.") 1986, states:

> 3. (1) If an affiliated group of corporations files a consolidated income tax return for the taxable year for federal income tax purposes and fifty percent or more of its income is derived from sources within this state as determined in accordance with section 143.451, then it *may elect to file* a Missouri consolidated income tax return. The federal consolidated taxable income of the electing affiliated group for the taxable year shall be its federal taxable income. (Emphasis supplied).

Thus, the decision to file a consolidated return lies with the taxpayer, who must affirmatively choose this method of reporting its income.

Here, the petitioners each filed a separate Missouri corporate income tax return for the years in question. Petitioners' brief at 8-9. They later filed amended returns on a *combined* basis accompanied by claims for refunds. Petitioners' Brief at 9. Along with the amended returns was a request to file consolidated returns. Jt. Ex. 1A, ¶¶ 27, 28, 31-34. Appellants have insisted throughout the proceedings in this case that there are

significant differences between combined reporting and consolidated returns. It follows that their amended returns should not be considered to be equivalent to consolidated returns. In short, petitioners did not choose to file consolidated returns for the years in question. This means that even if the requirements for filing a consolidated return which are included in Section 143.431 were unconstitutional, petitioners could not be afforded the relief they are seeking, since they have already elected to file separate returns.

This circumstance was considered by the Missouri Administrative Hearing Commission in its disposition of this case. The Commission, it should be noted, accepted the contention that Missouri law afforded the petitioners an opportunity to file their returns on a combined or consolidated basis, notwithstanding the fact that less than fifty percent of the affiliated group's income was derived from sources inside this state. The Commission stated:

> Certainly, both combined reporting and consolidated returns are potentially available to Williams, for the Director is vested with broad discretion to allow—or require—whatever means of reporting best reflects the taxpayer's tax liability under the circumstances.

Petitioners' Brief at 37a. Nevertheless, the Commission ruled against the petitioners, because Missouri law required that they choose their filing method before filing their original returns. Petitioners' Brief at 37a. The Commission noted, that

> [o]nce a taxpayer has elected to file on a particular basis, that election is irrevocable. *Bartlett & Company Grain v. Director of Revenue*, 649 S.W.2d 220 (Mo. 1983). The Director cannot be compelled—and may lack authority—to permit taxpayers to avoid the adverse effects of their own lack of foresight by belated amendment of their returns.

Id.

Thus, before it may consider whether to strike down Section 143.431, as urged by the petitioners, this Court must face the identical issue decided by the Commission, namely: does Missouri law permit petitioners to reverse their decision to file separate Missouri corporate income tax returns? The resolution of this question is purely a matter of state law and is dispositive of this case.

The petitioners concede that whether they may file on a combined basis does not present a federal question. Petitioners' Brief at Note 2. Their petition focuses instead on whether they may file consolidated returns for the years in question. The Missouri Administrative Hearing Commission decision, as noted above, demonstrates that regardless of whether Section 143.431.3(1) is unconstitutional, petitioners may not file consolidated returns for the years in question. This issue was not considered by the Supreme Court of Missouri, which instead directed its attention to the issue of whether the statute was unconstitutional. Finding it to be constitutional, the Missouri Court affirmed the Commission's decision without any further discussion of this other issue.

Because the question of whether petitioners may file a consolidated return can thus be disposed of on a state ground, it does not present a basis for the exercise of this Court's jurisdiction under 28 U.S.C. § 1257(a). Additionally, because petitioners filed amended returns on a combined basis, and did not file consolidated returns, the disposition of the consolidated return issue by this Court would constitute an impermissible advisory opinion.

2. The decision of the Missouri Supreme Court concerning the Missouri statutory requirement for filing a Missouri consolidated return is consistent with the decisions of this Court and the other cases cited by the petitioners, and thus does not present a basis for granting the petition.

To support their claim that Section 143.431.3(1) favors in-state business over out-of-state business, the petitioners posit a hypothetical situation. Petitioners' Brief at 16-17. The problem with this example, however, is that it ignores the fact that the figures which the petitioners refer to as the "Missouri tax base" of the two hypothetical groups of corporations would be subject to formula apportionment before any tax were imposed. *See* § 143.451, RSMo 1986, Petitioners' Brief at 109a; § 32.200, RSMo 1986, Petitioners' Brief at 79a-104a. The two groups of affiliated taxpayers derive different proportions of their income from Missouri sources. The applicable apportionment factors, however, cannot be determined from the facts given. Thus, it is not possible to calculated what the true tax outcome would be in this situation.

It is axiomatic that the greater the proportion of income a taxpayer derives from Missouri sources, the larger its apportionment factor will be. Thus when apportionment is added to the equation, it is clear that a taxpayer who earns forty-nine percent of its income from Missouri sources and a taxpayer who earns fifty-one percent of its income from Missouri sources are simply *not* similarly situated vis-a-vis this state's income tax.

As the foregoing discussion illustrates, the effect of Section 143.431.3(1) cannot be accurately determined outside the context of apportionment. Section 143.431.3(1) is an integral part of the Missouri scheme for calculating the Missouri taxable income of a group of affiliated taxpayers. Thus, it is significantly different from the statutes at issue in the cases noted by the petitioners, since the Missouri statute does not impose a tax nor

grant a credit or exemption. *Cf. Westinghouse Electric Corporation v. Tulley*, 466 U.S. 388, 104 S. Ct. 1856, 80 L.Ed.2d 388 (1984); *Maryland v. Louisiana*, 451 U.S. 725, 101 S. Ct. 2114, 68 L.Ed.2d 576 (1981); *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318, 97 S. Ct. 599, 50 L.Ed.2d 514 (1977); *Delta Air Lines, Inc. v. Department of Revenue*, 455 So.2d 317 (Fla. 1984); *Comptroller v. Armco, Inc.*, 521 A.2d 785 (Md. App. 1987). Moreover, consolidated returns do not necessarily result in tax savings. Indeed, the cases cited by the petitioners on this topic demonstrate that this Court has repeatedly been asked by taxpayers to relieve them from the burden of being treated as a consolidated group for tax purposes. *See, e.g., Container Corp. of America v. Franchise Board*, 463 U.S. 159, 103 S. Ct. 2933, 77 L.Ed.2d 545 (1983).

This Court has recognized that formula apportionment is an "imperfect prox[y] for an ideal which is not only difficult to achieve in practice,but difficult to describe in theory." *Container Corp.*, 463 U.S. at 182. In keeping with this principle, this Court has determined that "the Constitution imposes no single formula on the States" when it comes to determining the state taxable income of a group of related corporations. *Id.* at 164 (citing *Wisconsin v. J. C. Penney Co.*, 311 U.S. 435, 446, 61 S. Ct. 246, 250, 87 L.Ed. 267 (1947)).

As the Missouri Supreme Court noted, the Missouri scheme follows a middle course between formula apportionment and separate accounting, and is neither arbitrary nor irrational. As the Court explained,

> Section 143.431.2 is fashioned on the principle that formula apportionment of the income of a unitary affiliated group is more likely to be "fairly apportioned, non-discriminatory, sufficiently connected with the taxpayer's state activities, and fairly related to state benefits provided the taxpayer," *Mobil*, 445 U.S. at 443, when the affiliated group derives

> the majority of its income from in-state sources. Conversely, when the unitary group's income derives primarily from sources outside the state, formula apportionment of the income of only those subsidiaries with direct relationships to the State yields a corpus of income more reasonably related to the group's activities within the state.

799 S.W.2d at 605.

The petitioners also attack the Missouri Court's view that "the legal form in which a taxpayer clothes its business is one of its own choosing. The fact that a form that is well suited to some purposes does not also minimize Missouri taxes does not violate the Commerce Clause of the United States Constitution." 799 S.W.2d at 605. This conclusion is consistent with the view that taxpayers who come within Section 143.431.2(1) and those who do not, are not otherwise similarly situated in regard to the Missouri income tax, and thus the statute is not discriminatory. Furthermore, it is a correct statement that nothing in Missouri law requires appellants to conduct their business through a variety of corporate subsidiaries. The decision to do business through these subsidiaries was the choice made by the petitioners, based upon numerous factors, one of which might have been taxation.

Finally, it should be noted that even if this Court were to grant the petition and rule that the fifty percent source of income requirement of Section 143.431 is unconstitutional, the result of such a ruling would be that no taxpayers would be entitled to file a consolidated return in Missouri. This is because the challenged portion of the Missouri statute is not severable. As the Missouri Supreme Court has explained:

> The test of the right to uphold the law, some portions of which may be invalid, is whether or not in so doing, after separating that which is invalid, a law in all respects complete and susceptible of constitutional enforcement is

left, which the legislature would have enacted if it had known that the excised portions were invalid. *State ex rel. Audrain County v. Hackman*, 275 Mo. 534, 543, 205 S.W.2d 12, 14 (Mo. banc 1988).

Simpson v. Kilcher, 749 S.W.2d 386, 393 (Mo. banc 1988).

The Missouri legislature most certainly would not have enacted Section 143.431.3 minus the provision challenged by the petitioners. It was the obvious intent of the legislature to place a limit on corporations filing consolidated returns in this state, and the removal of the fifty percent requirement from the statute would negate this intent. If the legislature had intended to permit the "wide open" filing of consolidated returns in Missouri, it would never have included the fifty percent provision in the first place. Moreover, the elimination of this option would be entirely consistent with the United States Constitution. *Cf. Exxon Corporation v. Wisconsin Department of Revenue*, 447 U.S. 207, 222-223, 100 S. Ct. 2109, 2129, 67 L.Ed.2d 66 (1980). Thus, if the fifty percent requirement is declared unconstitutional, then the offending provisions cannot be properly severed from the remainder of the subsection.

3. The decision of the Supreme Court of Missouri concerning the taxation of capital gain earned by Williams Pipeline Company from the sale of stock in Wood River Pipeline Corporation, is consistent with the decisions of this court, and does not present a substantial federal question to support granting of the petition.

The Missouri Administrative Hearing Commission and the Missouri Supreme Court both found that the record in this case supported the conclusion that capital gains derived from the sale of stock in Wood River Pipeline Corporation ("Wood River") constituted "business income" for William Pipeline Company ("WPL"). This finding was based on the conclusion that WPL

and Wood River were engaged in a unitary business. Petitioners contend that this finding is inconsistent with the due process clause, because WPL did not own a controlling stock interest in Wood River.

Contrary to the petitioners' assertions, however, the decisions of this Court do not set forth such a "bright line" test for determining when capital gains constitute business income from a unitary business. *See Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159, 178, 103 S. Ct. 2933, 2947, 77 L.Ed.2d 545 (1983). *Cf. ASARCO, Inc. v. Idaho State Tax Commission*, 458 U.S. 307, 321, 102 S. Ct. 3103, 3111-3112, 73 L.Ed.2d 787 (1982). Instead, this Court has espoused a pragmatic approach, which takes many factors into account. In *Container Corp*, this Court stated that "the unitary business concept is . . . not, so to speak, unitary: there are variations on the theme, and any number of them are logically consistent with the underlying principles motivating the approach." 463 U.S. at 167. This Court also noted that "the unitary business principle could apply, not only to vertically integrated enterprises, but also to a series of similar enterprises operating separately in various jurisdictions, but linked by common managerial or operation resources that produced economies of scale and transfer of value." 463 U.S. at 166. The due process principles set out above require:

> [T]hat the out of state activities of the purported 'unitary business' be related in some concrete way to the in-state activities. The functional meaning of this requirement is that there be some sharing or exchange of value not capable of precise identification or measurement—beyond the mere flow of funds arising out of a passive investment or a distinct business operation—which renders formula apportionment a reasonable method of taxation.

463 U.S. at 166. Due process also requires "some bond of ownership or control uniting the purported 'unitary business.' " *Id.*

This Court in the *Container Corp.* case also approved a reasonable administrative presumption that corporations engaged in the same line of business are unitary. 463 U.S. at 178. "When a corporation invests in a subsidiary that engages in the same line of work as itself, it becomes much more likely that one function of the investment is to make better use—either through economies of scale or through operational integration or sharing of expertise—of the parent's existing business-related resources." *Id.*

The factors which this Court considered in *Container Corp.* in determining whether a parent and its subsidiaries constituted a unitary business included:

> appellant's assistance to its subsidiaries in obtaining used and new equipment and in filling personnel needs that could not be met locally, the substantial role played by appellant in loaning funds to the subsidiaries and guaranteeing loans provided by others, the 'considerable interplay between appellant and its foreign subsidiaries in the area of corporate expansion,' the 'substantial' technical assistance provided by appellant to the subsidiaries, and the supervisory role played by appellant's officers in providing general guidance to the subsidiaries. (Citations omitted)

Container Corp., 463 U.S. at 179. This Court went on to say that:

> We need not decide whether any one of these factors would be sufficient as a constitutional matter to prove the existence of a unitary business. Taken in combination, at least, they clearly demonstrate that the state court reached a conclusion "within the realm of permissible judgment."

463 U.S. at 179-180.

Under this definition, Wood River was part of WPL's unitary business. Wood River and WPL were linked by operational resources that produced economies of scale and transfer of value. "Wood River was a joint venture by which Koch and WPL were able to accomplish an operational purpose otherwise outside of their respective capabilities." Petitioners' Brief at 44a. Wood River and WPL were both pipeline companies. *Id.* Wood River served to reduce WPL's overhead "and increase the profitability of WPL's existing pipelines in the shared rights-of-way." *Id.* Wood River also converted a $37 million dollar expenditure by WPL into a profit. *Id.* Furthermore, "[t]he Wood River line was available to WPL, and WPL used it for several months." *Id.* at 45a.

It is true that Koch, not WPL, controlled the Board of Directors. *Id.* Koch owned all of the common stock of Wood River which entitled Koch to elect four directors, while WPL owned all of the preferred stock which allowed WPL to elect one director. *Id.* at 30a. This fact was not overlooked by the Missouri Administrative Hearing Commission, or the Missouri Supreme Court; instead, they properly noted that it was just one consideration in determining the scope of the unitary business.

Furthermore, the *Container Corp.* opinion also indicates that control may be implicit. 463 U.S. at Note 16. In this case, the record establishes that WPL was in physical control of at least two segments of the pipeline. The pipeline was constructed on WPL's right-of-way. Petitioners' Brief at 30a, 31a. "WPL managed the day to day affairs of the Bethany-Mason City and Mason City-Pine Bench and Cottage Grove Pipelines." *Id.* at 32a. Wood River appointed WPL as its agent for these pipelines. *Id.* WPL also agreed to perform inspections, repairs and maintenance for Wood River on these pipelines. *Id.* at 31a. All of these findings by the trier of fact in this case, the Missouri Administrative Hearing Commission, point to physical control of the pipeline by WPL. Moreover, as petitioners note in their

brief, "if Wood River did not pay any preferred dividend within 36 months of its schedule declaration date, it would be in 'default.' If default occurred, the board of directors would be reconstituted so as to provide WPL with control." Petitioners' Brief at 11-12.

In sum, the facts of this case do not support the conclusion that WPL's interest in Wood River Pipeline was "merely a passive investment." 463 U.S. at 166. The finding that Wood River and WPL constituted a unitary business and that the gains derived from the sale of Wood River stock was business income, are entirely consistent with the due process clause and this Court's opinions.

CONCLUSION

For these reasons, the petition for a writ of certiorari should be denied.

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No. 90-1458

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In The

Supreme Court of the United States

October Term, 1990

THE WILLIAMS COMPANIES, INC. AND ITS DOMESTIC SUBSIDIARIES, INCLUDING WILLIAMS NATURAL GAS COMPANY, WILLIAMS PIPE LINE COMPANY, WRC OF MISSOURI, INC., AGRICO CHEMICAL COMPANY, WILLCO, INC. (EDGCOMB METALS COMPANY), WILLBROS TERMINAL COMPANY, AND WRC OF CROWN CENTER, INC.,

Petitioners,

v.

DIRECTOR OF REVENUE, STATE OF MISSOURI,

Respondent.

Petition For A Writ Of Certiorari To The Supreme Court Of Missouri

PETITIONERS' REPLY TO RESPONDENT'S BRIEF IN OPPOSITION

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I. QUESTIONS PRESENTED

Missouri law permits (but does not require) an affiliated group of corporations to file a Missouri consolidated income tax return if the affiliated group (i) files a consolidated return for Federal income tax purposes and (ii) derives fifty percent (50%) or more of its income from Missouri sources. Petitioners, an interstate, multicorporate, unitary business, under the umbrella of The Williams Companies, Inc., filed a Federal consolidated return but did not derive fifty percent (50%) or more of their income from Missouri sources for the years at issue. Also, Respondent maintains, and the Missouri Supreme Court held in this case, that Missouri law does not permit the filing of a combined report on a unitary apportionment basis.

For the years at issue, Petitioners initially filed their Missouri corporate income tax returns with the Respondent on a separate corporation basis. Subsequently, Petitioners submitted refund claims to Respondent alternatively on a consolidated return or combined report basis.

Also, during the tax years at issue, one of the Petitioners, Williams Pipe Line Company, sold a preferred stock investment, the gain from which Missouri seeks to tax as apportionable "business income."

The questions presented are:

1. Whether the Missouri Supreme Court erred in denying Petitioners' refund claims on a consolidated return basis because the Missouri statutory requirement that an affiliated group of corporations earn more than

QUESTIONS PRESENTED-Continued

fifty percent (50%) of its income in Missouri as a condition to filing consolidated Missouri income tax returns discriminates against interstate commerce in violation of the Commerce Clause of the United States Constitution?

2. Whether the Missouri Supreme Court erred in upholding Missouri's assessment, which apportions capital gain income derived from the sale of preferred stock to Missouri as "business income" under the Multistate Tax Compact, when the seller had no unitary relationship with the issuing corporation, thereby taxing an activity with which Missouri lacks nexus, in violation of the Due Process Clause of the United States Constitution?

PARTIES TO THE PROCEEDING AND RULE 29.1 STATEMENT

A list naming all parent companies and subsidiaries (except wholly owned subsidiaries) of each corporate Petitioner was included in the Petitioners' Petition For A Writ of Certiorari to the Supreme Court of Missouri at pp. iii-v. There are no amendments to this list needed to make it currently accurate.

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No. 90-1458

In The

Supreme Court of the United States

October Term, 1990

THE WILLIAMS COMPANIES, INC. AND ITS DOMESTIC SUBSIDIARIES, INCLUDING WILLIAMS NATURAL GAS COMPANY, WILLIAMS PIPE LINE COMPANY, WRC OF MISSOURI, INC., AGRICO CHEMICAL COMPANY, WILLCO, INC. (EDGCOMB METALS COMPANY), WILLBROS TERMINAL COMPANY, AND WRC OF CROWN CENTER, INC.,

Petitioners,

v.

DIRECTOR OF REVENUE, STATE OF MISSOURI,

Respondent.

Petition For A Writ Of Certiorari To The Supreme Court Of Missouri

PETITIONERS' REPLY TO RESPONDENT'S BRIEF IN OPPOSITION

Petitioners, The Williams Companies, Inc., and its domestic subsidiaries for the tax years at issue, respectfully submit the Petitioners' Reply to Respondent's Brief in Opposition, in support of Petitioners' request for this Court to issue a Writ of Certiorari to review the judgment of the Supreme Court of Missouri entered in this action on November 20, 1990 (the "Missouri Supreme Court's Opinion"). The Petitioners' Petition for a Writ of Certiorari to the Supreme Court of Missouri (the "Petition") was filed with this Court on

March 15, 1991, and the Respondent's Brief in Opposition (the "Respondent's Brief") was filed with this Court on June 6, 1991. This Reply Brief is submitted pursuant to Rule 15.6 of the Rules of this Court and is addressed solely to arguments first raised in the Respondent's Brief.

THE RESPONDENT'S BRIEF IN OPPOSITION OFFERS NO SOUND REASON WHY THE PETITION SHOULD BE DENIED.

1. The Missouri Supreme Court's Opinion Upholding the Fifty Percent Source-of-Income Requirement for Filing a Missouri Consolidated Income Tax Return Decided a Federal Question and Was Not Based on Independent Grounds of State Law.

The Respondent's Brief submits that the Petition should be denied because independent state grounds[1] exist for the Missouri Supreme Court's Opinion which, according to Respondent, must be resolved "before" any decision on the constitutionality of the fifty percent (50%) source-of-income requirement (the "Requirement") for filing a Missouri consolidated income tax return. Respondent's Brief, p. 4. It is true that the Respondent urged the Missouri Supreme Court to decide this case on threshold state law considerations and that the decision of the Missouri Administrative Hearing Commission, the

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[1] The purported independent state procedural grounds involve whether Missouri law permits corporate income tax returns to be amended on an alternative filing basis after an initial filing has been made. The Respondent also asserts that independent state procedural grounds exist because Petitioners' "amended returns should not be considered to be equivalent to consolidated returns." Respondent's Brief, p. 3. The Missouri Supreme Court's Opinion unequivocally rejected this latter contention, holding that "In 1987, appellants filed *consolidated* amended Missouri corporate income tax returns for 1982 through 1984. . . . " Petition, App. 2a (Emphasis added).

intermediate appellate tribunal, had resolved such state procedural issues against the Petitioners. Petition, App. 37a. However, this Court considers "only the final action of the supreme court of the state in disposing of the controversy" and is "unconcerned with the conclusions" of a subordinate appellate tribunal. *Allen v. Southern Pac. R. Co.*, 173 U.S. 479, 489 (1899). The Missouri Supreme Court's Opinion did not address state procedural issues; it unambiguously reached the substantial Federal issue which Petitioners urge this Court to review.

This Court had held that "the possibility that the state court might have reached the same conclusion if it had decided the question purely as a matter of state law does not create an adequate and independent state ground that relieves this Court of the necessity of considering the federal question." *United Airlines, Inc. v. Mahin*, 410 U.S. 623, 630-631 (1973); *Zacchini v. Scripps-Howard Broadcasting Co.*, 433 U.S. 562, 568 (1977). Further, if the opinion of the state's highest court clearly indicates that its decision rested solely on federal grounds, it is presumed that the state court "either rejected or failed to reach the asserted state grounds." *Poafpybitty v. Skelly Oil Co.*, 390 U.S. 365, 375-376 (1968).

Significantly, the Respondent correctly notes that state procedural issues were "not considered by the Supreme Court of Missouri, which instead directed its attention to the issue of whether the statute was unconstitutional. Finding it to be constitutional, the Missouri Court affirmed the Commission's decision without any further discussion of this other issue." Respondent's Brief, p. 4. The Missouri Supreme Court's "willingness to reach the merits of petitioner's federal claims provides convincing proof that the judgment does not rest on adequate state grounds." *Wardius v. Oregon*, 412 U.S. 470, 477 (1973). Indeed, since the state procedural issues are threshold issues, as Respondent acknowledges, by reaching the Federal question, the Missouri Supreme Court

implicitly resolved such state procedural issues in favor of Petitioners.

In short, since the Missouri Supreme Court's Opinion upheld the Requirement on Federal constitutional grounds and not on independent state grounds, a substantial Federal question is properly presented for review by this Court.

2. The Issue of the Severability of the Fifty Percent Source-of-Income Requirement for Filing a Missouri Consolidated Income Tax Return from the Remainder of the Statute Was Not Addressed in the Missouri Supreme Court's Opinion and, Accordingly, Is Not Presented in this Proceeding.

The Respondent's Brief erroneously maintains that a decision by this Court to strike down the Requirement would result in "no taxpayers . . . entitled to file a consolidated return in Missouri . . . because the challenged portion of the Missouri statute is not severable." Respondent's Brief, p. 7. The Missouri Supreme Court's Opinion did not address the severability of the Requirement and, accordingly, such issue is not presented in this proceeding. The severability issue is reached *only* in the event that the Requirement is struck down by this Court, and could properly be considered by the Missouri Supreme Court only on remand. Contrary to the Respondent's contention, the outcome of the severability issue is not foreordained in the Respondent's favor.[2]

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[2] Respondent states that "the obvious intent of the legislature [was] to place a limit on corporations filing consolidated returns in this state, and the removal of the fifty percent requirement from the statute would negate this intent." Respondent's Brief, p. 8. On the contrary, the Missouri Supreme Court has indicated that the intent behind the consolidated return statute was to permit an affiliated group to be

(Continued on following page)

Clearly, the mere possibility that the Missouri Supreme Court could construe the consolidated return statute to deny the filing of any consolidated returns by refusing to sever the Requirement, does not eliminate the need for a determination of the constitutionality of the Requirement by this Court. Indeed, the unstated premise of the Respondent's contention is that since the Requirement may not be severable, there is an independent state ground precluding review of the Missouri Supreme Court's Opinion. On the contrary, it is well established that if a Federal question exists which precedes or "opens the door to the application of the state law," no independent state law basis of decision is presented and the case may properly be considered by this Court. *Ivanhoe Irrigation District v. McCracken*, 357 U.S. 275, 290, *reh'g denied*, 358 U.S. 805 (1958), *overruled on other grounds, California v. United States*, 438 U.S. 645 (1978), *on remand* 509 F. Supp. 867 (E.D. Cal. 1981).

The Respondent also claims that no significant Commerce Clause problem is presented by the Requirement because an affiliated group of taxpayers that satisfies the Requirement is not similarly situated with an affiliated group that does not satisfy the Requirement. According to Respondent, the hypothetical situation presented by Petitioners at pages 16 and 17 of the Petition comparing

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(Continued from previous page)

taxed "somewhat equally with one large corporation." *Mid-America Television v. State Tax Commission*, 652 S.W.2d 674, 680 (Mo. en banc 1983), *cert. denied*, 465 U.S. 1065 (1984). The Requirement is not essential to that intent. Accordingly, the Requirement is not so "essentially and inseparably connected with" the remainder of the consolidated return statute that the whole statute must fall if the Requirement is struck down. Mo. Rev. Stat. § 1.140 (1976). Accordingly, if this issue is reached, the Requirement should be deemed severable from the remainder of the consolidated return statute.

such groups is unsound because the "applicable apportionment factors . . . cannot be determined from the facts given. Thus, it is not possible to calculated [sic] what the true tax outcome would be in this situation." Respondent's Brief, p. 5. On the contrary, the hypothetical situation presented assumed that the *only* difference between the two affiliated groups of taxpayers was the *source* of the groups' income.

To determine whether fifty percent (50%) of an affiliated group's income is derived from Missouri sources, one looks to the geographic location of the group's revenues. The consolidated return filing statute requires that "fifty percent or more of [the group's] income is derived from sources within this state *as determined in accordance with section 143.451* . . . ". Petition, App. 107a (Emphasis added). Section 143.451 identifies Missouri source income on a geographic, receipts basis. Petition, App. 109a-113a.

The hypothetical situation presented in the Petition assumes that the property and payroll factors (the other two apportionment favors in addition to the receipts factor) are the same for both groups of hypothetical taxpayers. Only the receipts factor, representing the source of the groups' income, is different.[3] Therefore, the hypothetical affiliated groups of taxpayers are similarly situated. The hypothetical example properly demonstrates that the Requirement has the "discriminatory effect of taxing the same amount of income *apportioned* to Missouri

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[3] As a result, the Respondent's Brief also incorrectly argues that "the greater the proportion of income a taxpayer derives from Missouri sources, the larger its apportionment factor will be." Respondent's Brief, p. 5. Increasing an affiliated group's income from Missouri sources will increase *only* the receipts factor; it implies nothing with respect to the property and payroll factors which are averaged with the receipts factor to derive the taxpayer's apportionment factor.

by two different groups of affiliated taxpayers at different effective rates. . . . " Petition, p. 16. (Emphasis added).

As the Respondent correctly states, the Requirement is "an integral part of the Missouri scheme for calculating the Missouri taxable income of a group of affiliated taxpayers." Respondent's Brief, p. 5. As "an integral part" of the Missouri tax calculation "scheme," the Requirement is clearly within the reach of this Court's decisions striking down other discriminatory state tax structures, even though the Requirement does not itself "impose tax nor grant a credit or exemption." Respondent's Brief, pp. 5-6.

As a result of this facially discriminatory Requirement, both the location of interstate business and the form in which a taxpayer conducts its interstate business cease to be tax-neutral choices in violation of the Commerce Clause. Therefore, contrary to Respondent's contentions, the Missouri Supreme Court's Opinion upholding the Requirement presents a substantial Federal question and is in conflict with decisions of this Court and of the highest court of another state.

3. The Missouri Supreme Court's Opinion Upholding Apportionment of the WPL Capital Gain as Unitary "Business Income" Decided a Federal Question under the Due Process Clause in a Way that Conflicts with Decisions of this Court and of the Highest Courts of Other States.

Petitioners also contend that the Respondent's attempt to tax the capital gain from the sale by Williams Pipe Line Company ("WPL") of its preferred stock in Wood River Pipeline Corporation ("Wood River") is unconstitutional because WPL did not own a controlling stock interest in Wood River and did not exercise control by any other means. The Respondent suggests that the Missouri Supreme Court's Opinion found that WPL had "implicit" control over Wood River. Respondent's Brief, p. 11. Nowhere in the Missouri Supreme Court's Opinion is there any indication that the Court determined from

the facts that WPL controlled Wood River in any fashion; the contrary, the Court expressly held that "Koch Industries, Inc., controlled" Wood River. Petition, App. 9a.[4] Moreover, to assert, as the Respondent does, that the sundry maintenance, repair, and construction services that WPL provided to Wood River somehow constituted "physical control" of Wood River by WPL is to misconstrue the meaning of "control." The services which WPL performed were fully compensated pursuant to a formal agreement and were subject to the approval of Wood River and, thus, of Koch. The Respondent appears to suggest that WPL could somehow have "controlled" Wood River at the same time that Koch did, yet "control" means ultimate authority, something that, by definition, can only be held by one individual. Surely this is why this Court has never found that an investor and an investee formed a single unitary business where a third entity owned a majority interest in the investee.

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[4] The Respondent's Brief contains several quotations from and citations to the opinion of the Missouri Administrative Hearing Commission (the "Commission") in this matter. The Respondent misleadingly implies that the facts found by the Commission concerning WPL's relationship with Wood River were accepted in their entirety by the Missouri Supreme Court. As the Respondent is well aware, the Petitioners previously have argued that several of the Commission's findings of fact were not supported by the record. The Missouri Supreme Court's Opinion did not reach this issue, because it held that the undisputed facts in this case, by themselves, provided sufficient grounds for holding that Wood River was part of WPL's unitary business. Petition, App. 11a ("[i]t is unnecessary to reach the question of whether certain other findings of fact that appellants dispute are supported by the record"). While the Petitioners also contend that the Respondent could not constitutionally tax the WPL capital gain even if all of the facts as set forth by the Commission were accurate, it is clear that the Missouri Supreme Court's Opinion was not predicated on the accuracy of all of the Commission's findings of fact.

The Respondent also suggests that there is some significance to the fact that WPL would have gained the right to elect a majority of Wood River's directors if Wood River "defaulted" by failing to pay any preferred dividend within 36 months of its scheduled declaration date. It is undisputed, however, that Wood River never defaulted on any preferred dividend. Petition, App. 30a. The existence of the default provision is no more constitutionally meaningful than the possibility that WPL could have elected a majority of Wood River's directors if it had purchased a majority of Wood River's common stock from Koch – both scenarios are entirely conjectural and thus utterly irrelevant to the issue of whether WPL and Wood River constituted a single unitary business.

The existence of control is not "just one consideration in determining the scope of the unitary business." Respondent's Brief, p. 11. Rather, it is a *"prerequisite"* to the existence of a unitary business relationship. *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159, 177, n. 16, *reh'g denied*, 464 U.S. 909 (1983) (Emphasis added). In finding that Wood River was a part of WPL's unitary business despite the fact that WPL did not control Wood River, the Supreme Court of Missouri has reached a result contrary to the decisions of this Court and of the highest courts of other states. *See Corning Glass Works, Inc. v. Virginia Dep't. of Taxation*, 402 S.E.2d 35, 40 (Va. 1991) (holding that a unitary business relationship legally could not have existed where the investor corporation had been barred from exercising control by the terms of an antitrust consent decree); *True v. Heitkamp*, 1991 WL 80989 (N.D.) (corporations did not form a unitary business because no one individual within the unitary group controlled all members of th group).

CONCLUSION

For the foregoing reasons, there are special and important reasons that a Writ of Certiorari should be issued to the Supreme Court of Missouri.

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